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IN THE
Supreme Court of the United States

OCTOBER TERM, 1989

MOBIL OIL EXPLORATION & PRODUCING
SOUTHEAST, INC., *et al.*,
Petitioners,

v.

UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

**PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT**

JAY G. MARTIN
GENE ANN HERRIN
MOBIL NATURAL GAS INC.
12450 Greenspoint Drive
Houston, Texas 77060
(713) 775-2000

CHARLES M. DARLING, IV
STEVEN C. TEICHLER
BAKER & BOTTS
555 13th Street, N.W.
Suite 500 East
Washington, D.C. 20004
(202) 639-7700

REX E. LEE *
EUGENE R. ELROD
CARTER G. PHILLIPS
GENE C. SCHAEER
JEFFREY T. GREEN
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000

* Counsel of Record

(Additional Counsel Listed On Inside Front Cover)

March 14, 1990

12498

Of Counsel:

WILLIAM H. EMERSON
P. O. Box 87703
Chicago, Illinois 60680
and

STEPHEN A. HERMAN
DAVID G. NORRELL
KIRKLAND & ELLIS
655 15th Street, N.W.
Suite 1200
Washington, D.C. 20005

Attorneys for
Amoco Production Co.

MARIO M. GARZA
P. O. Box 1330
Houston, Texas 77251
and

R. GORDON GOOCH
TRAVIS & GOOCH
1100 Fifteenth Street, N.W.
Suite 1200
Washington, D.C. 20005

Attorneys for
Anadarko Petroleum
Corporation

HARRIS S. WOOD
KATHLEEN E. MAGRUDER
NORMA J. ROSNER
P. O. Box 2819
Dallas, Texas 75221
and
HARRY E. BARSH, JR.
CAMP, BARSH, BATES & TATE
2550 M Street, N.W.
Suite 275
Washington, D.C. 20037

Attorneys for
ARCO Oil and Gas Company

GARY J. CELESTINO
BRIAN J. BELL
P.O. Box 218330
Houston, Texas 77218

Attorneys for
Ashland Exploration, Inc.

GERALD P. THURMOND
1301 McKinney
Suite 2200
Houston, Texas 77010
and

DAVID J. EVANS
DANIEL JOHN REGAN, JR.
PILLSBURY, MADISON & SUTRO
1667 K Street, N.W.
Suite 1100
Washington, D.C. 20006

Attorneys for
Chevron U.S.A. Inc.

ERNEST J. ALTGELT, III
BROCK G. RIDGEWAY
P. O. Box 2197
McLean Building
Houston, Texas 77252

Attorneys for
Conoco Inc.

C. ROGER HOFFMAN
DOUGLAS W. RASCH
P. O. Box 2180
Houston, Texas 77251-2180

Attorneys for
Exxon Corporation

GERALD M. BENDO
TONI D. HENNIKE
Fountain Place
1445 Ross at Field
Dallas, Texas 75202

Attorneys for
Hunt Oil Company

ROBERT C. PLATT
1250 Connecticut Ave., N.W.
Suite 800
Washington, D.C. 20036

Attorney for
Independent Petroleum
Association of America

ROBERT C. MURRAY
P. O. Box 3128
Houston, Texas 77253
and

THOMAS G. JOHNSON
JACKSON & WALKER
1100 Louisiana
Suite 4200
Houston, Texas 77002-5219

Attorneys for
Marathon Oil Company

JOHN B. CHAPMAN
SYLVIA MCCORMACK
P. O. Box 2967
Houston, Texas 77252-2967
and

JOHN K. McDONALD
BUTLER & BINION
1747 Pennsylvania Ave., N.W.
Suite 900
Washington, D.C. 20006

Attorneys for
Pennzoil Company

JOHN L. WILLIFORD
LARRY PAIN
LUKE A. MICKUM
1256 Adams Building
Bartlesville, Oklahoma 74004

Attorneys for
Phillips Petroleum Company
and Phillips 66 Natural Gas
Company

ROBERT A. MILLER, JR.
12596 W. Bayaud
Suite 400
Lakewood, Colorado 80228

Attorney for
Plains Petroleum Company

JOHN J. WOLFE
200 Crescent Court
Suite 300
Dallas, Texas 75201

Attorney for
Rosewood Resources, Inc.

MICHAEL L. PATE
P. O. Box 300
Tulsa, Oklahoma 74102

Attorney for
OXY USA Inc.

CHARLES J. MCCLEES, JR.
JAMES A. RUOFF
Room 4716
One Shell Plaza
P. O. Box 2463
Houston, Texas 77252

and
THOMAS G. JOHNSON
JACKSON & WALKER
1100 Louisiana
Suite 4200
Houston, Texas 77002-5219

Attorneys for
Shell Offshore Inc. and
Shell Western E&P Inc.

THOMAS B. DEAL
P. O. Box 2880
Dallas, Texas 75221-2880

Attorney for
Oryx Energy Company
(formerly Sun Exploration
and Production Company)

DEE H. RICHARDSON
ERNEST L. KUBOSH
4635 Southwest Freeway
Suite 900
Houston, Texas 77027

Attorneys for
Union Oil Company
of California

KERRY R. BRITTAIN
ALAN W. TOMME
Mail Station No. 4010
P. O. Box 7
Fort Worth, Texas 76101

Attorneys for
Union Pacific Resources Co.

RALPH J. PEARSON
P. O. Box 52332
Houston, Texas 77052
Attorney for
Texaco Inc.

TIMOTHY JACQUET
P. O. Box 2120
Houston, Texas 77251
Attorney for
Union Texas Petroleum
Corporation

QUESTION PRESENTED

Whether the court of appeals exceeded its reviewing authority or otherwise erred in vacating a nationwide program of the Federal Energy Regulatory Commission designed to increase production of low-cost natural gas and to eliminate severe distortions caused by the pre-existing ceiling price structure applicable to "old gas," i.e., gas in the interstate market from wells drilled prior to 1977. Specifically, whether the court of appeals applied an improper standard or otherwise erred:

(1) in setting aside, without regard to the plain statutory language and based solely on the court's reading of the legislative history, the Commission's determination that the Natural Gas Policy Act of 1978 permits the Commission to modify the pre-existing pricing scheme by setting a single, higher ceiling price for old gas;

(2) in setting aside the Commission's determination that the Natural Gas Act authorizes the Commission to specify by rule, rather than case-by-case adjudication, the circumstances in which the Commission will permit abandonment of a facility or service subject to its jurisdiction; and

(3) in requiring the Commission to solve, in *this* proceeding, another natural gas policy issue already being addressed in other proceedings—the issue of "take-or-pay" provisions in gas contracts—as a precondition to the Commission's effort to resolve the problem of old gas pricing.

LIST OF PARTIES

A list of parties and the statement required by Rule 29.1 are included in Appendix F to this petition. App., *infra*, 76a-82a.

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UNITED DISTRIBUTION COMPANIES, *et al.*,
Respondents.

**PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT**

Petitioners hereby petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-36a), together with the dissenting opinion of Judge Brown (App. 36a-57a), is reported at 885 F.2d 209 (5th Cir. 1989). Order No. 451 of the Federal Energy Regulatory Commission is reprinted at 51 Fed. Reg. 22,168 (1986) and III FERC Stats. & Regs. (CCH) ¶ 30,701 (1986). Order No. 451-A of the Federal Energy Regulatory Commission is reprinted at 51 Fed. Reg. 46,762 (1986) and III FERC Stats. & Regs. (CCH) ¶ 30,720 (1986).

JURISDICTION

The judgment of the court of appeals was entered on September 15, 1989. Rehearing was denied on December 15, 1989. App. 58a. This Court has jurisdiction under 28 U.S.C. § 1254(1). On January 16, 1990, this Court granted a stay of the mandate of the court of appeals

pending the timely filing of a petition for certiorari. App. 60a.

STATUTES AND REGULATIONS INVOLVED

Section 104(b)(2) of the Natural Gas Policy Act of 1978, which in all relevant respects is identical to Section 106(c) of the same Act, provides:

Ceiling prices may be increased if just and reasonable—The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—

(A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(B) just and reasonable within the meaning of the Natural Gas Act.

15 U.S.C. § 3314(b)(2); see also 15 U.S.C. § 3316(c).

Section 7(b) of the Natural Gas Act of 1938 provides:

No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission . . . that the present or future public convenience or necessity permit such abandonment.

15 U.S.C. § 717f(b).

The regulations adopted or amended pursuant to Orders No. 451 and 451-A are reproduced in the Appendix. App. 61a-75a.

STATEMENT

This case concerns the exhaustive efforts of the Federal Energy Regulatory Commission ("Commission" or "FERC") to develop a rational and efficient nationwide program for regulating prices of "old" natural gas, i.e.,

gas in the interstate market from wells drilled prior to 1977. That gas accounted for approximately 40 percent of the nation's production at the time of the Commission's decision. After lengthy deliberations over an extensive administrative record, the FERC adopted Orders No. 451 and 451-A (collectively "Order 451"), a carefully crafted set of regulations designed to reduce the serious market distortions and adverse effects on consumers created by the prior old gas pricing scheme. Those regulations formed the basis for a major restructuring of contractual relationships throughout the natural gas industry, a restructuring that involved the renegotiation of at least 3,000 contracts covering some seven trillion cubic feet of old gas. After more than three years of operation, however, the FERC's regulatory program was overturned by a sharply divided court of appeals, which held that the FERC lacked the authority to implement that program. If left in place, the court of appeals' decision not only would threaten the Commission's authority to resolve this and other regulatory issues within its jurisdiction, but also would cause severe dislocations throughout the natural gas industry by disrupting the salutary market restructuring that Order 451 has produced.

1. Historically, natural gas prices have been regulated principally under the Natural Gas Act of 1938 ("NGA"). 15 U.S.C. §§ 717-717w. Beginning in the 1960s, the Federal Power Commission ("FPC"), acting pursuant to the NGA, instituted a system of area-wide wellhead ceiling prices for natural gas. These ceiling prices were set pursuant to a system of "vintage" pricing under which one ceiling price was established for gas that had already been dedicated to interstate commerce—what was then considered "old" gas—and another, higher ceiling was established for "new" gas. Originally, the vintage pricing system was intended to be a mechanism for increasing natural gas supplies through higher ceilings on new gas, while moderating price increases to consumers through lower ceilings on existing supplies. See Opinion

No. 468, 34 F.P.C. 159, 185-88 (1965); see also 51 Fed. Reg. at 22,168, 22,173; App. 9a.

From the outset, both the FPC and the courts consistently treated vintage pricing as a temporary expedient, which the FPC, exercising its broad discretion under the NGA, remained free to modify or eliminate as experience and regulatory needs changed. See Statement of General Policy, No. 61-1, 24 F.P.C. 818, 819 (1960) ("It is anticipated that these differences in price levels will be reduced and eventually eliminated."). In upholding the FPC's system of area rates, for example, this Court made clear that the NGA does not prescribe any particular regulatory formula or methodology, including vintaging. *Permian Basin Area Rate Cases*, 390 U.S. 747, 775-77, 799-800 (1968). For that reason, the FPC received judicial approval when it implemented its 1972 conclusion that vintaging was "an anachronism which we should now move to eliminate." See Opinion No. 639, 48 F.P.C. 1299 (1972), *aff'd sub nom. Shell Oil Co. v. FPC*, 491 F.2d 82, 88 (5th Cir. 1974); Opinion No. 699-H, 52 F.P.C. 1604, 1631-32 (1974), *aff'd sub nom. Shell Oil Co. v. FPC*, 520 F.2d 1061 (5th Cir. 1975), *cert. denied*, 426 U.S. 941 (1976). The court of appeals also approved when the FPC, having reinstated vintaging in 1976, consolidated a number of the most outdated vintages into a single vintage category for all gas flowing prior to 1972. Opinion No. 749, 54 F.P.C. 3090 (1975), *aff'd sub nom. Tenneco Oil Co. v. FERC*, 571 F.2d 834 (5th Cir.), *cert. dismissed*, 439 U.S. 801 (1978). Despite that consolidation, the FPC's vintage pricing structure still contained 16 different categories of old gas—each with its own ceiling price—when the FERC inherited the FPC's regulatory authority in 1977. 51 Fed. Reg. at 22,170.

2. The vintage pricing structure contributed to the acute gas shortages experienced in the interstate market during the 1970s. Ceiling prices on many categories of gas were artificially low. Artificially low prices, in turn, generated a steady increase in demand for natural gas while at the same time reducing the supply available

to the interstate market. This reduction in supply was exacerbated by intense competition from an unregulated intrastate gas market, as well as by the ever-increasing costs of exploring for and developing new gas supplies. Periodic rate reviews by the FPC and the FERC, moreover, failed to keep up with this fast-changing market.¹

In an effort to eliminate gas shortages in the interstate market as well as to streamline and rationalize the regulatory process, Congress in 1978 enacted the Natural Gas Policy Act ("NGPA"), which "dramatically changed the method of pricing natural gas produced in the United States." *Public Service Comm'n v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 322 (1983). Contrary to the assumption of monopoly power on which the prior regulatory regime had been built, Congress determined that the producing segment of the natural gas industry was workably competitive. *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Bd.*, 474 U.S. 409, 420 (1986); *Pennzoil Co. v. FERC*, 645 F.2d 360, 378 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982). Accordingly, Congress immediately provided higher prices for "new" natural gas and put into place a scheme of phased deregulation for most of that gas. 92 Stat. 3350 (codified at 15 U.S.C. §§ 3301 *et seq.*).

Congress, however, did not restructure the pre-existing ceiling prices for old gas. Instead, in NGPA Sections 104 and 106, Congress simply adopted the ceiling prices that had been established by the Commission and made them subject to an automatic inflation adjustment. *Id.* §§ 3314(b)(1), 3316(a). But, even with this adjustment mechanism, "the statute recognize[d] that the ceiling[s] may be too low and authorize[d] the Commission to raise" them pursuant to certain statutory criteria. *Public Service Comm'n v. Mid-Louisiana Gas Co.*, *supra*, 463 U.S. at 333 (emphasis in original). Specifically, Sec-

¹ See generally S. Williams, *The Natural Gas Revolution of 1985* 1 (1987); Pierce, *Reconstituting the Natural Gas Industry From Wellhead To Burnertip*, 9 Energy L.J. 1, 8-11 (1988).

tions 104(b)(2) and 106(c) expressly authorized the Commission, "by rule or order," to change the ceiling prices for "any natural gas . . . or category thereof . . . otherwise subject to [Sections 104 and 106]," conditioned only by the requirements that the new ceiling be (1) *higher* than the ceilings set by the NGPA, and (2) "just and reasonable" within the meaning of the NGA. *Id.*

3. By 1985, the gas shortages of the 1970s had given way to excess supply. Yet the expected consumer benefits of this increase in supply—lower prices—had failed to materialize, largely because of the existing old gas pricing structure.² Accordingly, in a 1985 notice of proposed rulemaking, the Secretary of Energy urged the Commission to eliminate vintage pricing of old gas. 50 Fed. Reg. 48,540 (1985).³ According to the Secretary, vintage pricing of old gas had produced a number of adverse effects on the natural gas market and on the Nation's economy:

First, artificially low old gas prices under the vintage pricing system were causing producers to abandon production from old wells in favor of investment in new wells, which, although more expensive, were more profitable to producers because of higher price ceilings. 50 Fed. Reg. at 48,543. The Secretary estimated that 23 to 44 trillion cubic feet (Tcf) of old gas (one to two years' supply) would be permanently lost as a result. 50 Fed. Reg. at 48,540-541, 48,543.

Second, vintage pricing of old gas was causing increased reliance on imported gas and imported oil, thereby contributing to a deterioration in the Nation's balance

² See, e.g., S. Williams, *supra*, at 3-9; J. Kalt & F. Schuller, *Drawing the Line on Natural Gas Regulation* 4-8 (1987); P. Carpenter, H. Jacoby & A. Wright, *Adapting to Change in Natural Gas Markets* (1986); Pierce, *supra*, at 12-13.

³ Pursuant to section 403 of the Department of Energy Organization Act (42 U.S.C. § 7173(a)), the Secretary of Energy is authorized "to propose rules, regulations, and statements of policy of general applicability with respect to any function within the jurisdiction of the Commission. . . ."

of payments. 50 Fed. Reg. at 48,545. According to the Secretary, full recovery of old gas reserves would reduce imports of natural gas by \$5 to \$7 billion from 1985 to 1995, and would also reduce imports of oil by 300,000 to 350,000 barrels *per day* (worth about \$7.5 to \$8.8 million per day), thereby reducing "our vulnerability to oil supply disruptions." 50 Fed. Reg. at 48,544-545.

Third, vintage pricing of old gas was bad for consumers because it forced them to pay more for natural gas, on average, than they would absent the distortions created by the vintaging system. 50 Fed. Reg. at 48,543-544. According to the Secretary, full recovery of old gas supplies would "lower average consumer prices by \$0.19 to \$0.55 per Mcf [thousand cubic feet] from June 1985 to 1995." 50 Fed. Reg. at 48,543-544.

Fourth, apart from increasing gas prices to the average gas consumer, vintage pricing of old gas had created a "gargantuan inequity" in the treatment of consumers in various parts of the country because it forced consumers whose suppliers did not have significant inventories of low-priced old gas to pay substantially more than other gas customers. 50 Fed. Reg. at 48,541-542. These regional disparities, in turn, were giving industrial users in some regions of the country an artificial and unfair advantage over their competitors in other regions, and were forcing some groups of consumers to bear a disproportionate share of the costs of locating and recovering new gas supplies. 50 Fed. Reg. at 48,541-542.

In sum, according to the Secretary, vintage pricing of old gas was an "unnecessary anachronism" that can be understood only as an "accident of an historic ratemaking process that was ultimately unsuccessful in accomplishing its stated objectives of ensuring an adequate supply of natural gas for consumers at reasonable prices while providing a reasonable return and incentive for producers." 50 Fed. Reg. at 48,542. The Secretary therefor urged the Commission to use its authority under

Sections 104(b)(2) and 106(c) to eliminate vintage pricing of old gas by increasing the maximum lawful price for all old gas to the existing ceiling price for the post-1974 old gas vintage. 50 Fed. Reg. at 48,545.

4. The Commission analyzed approximately 113 sets of comments and held two days of public hearings on the Secretary's proposal. Then, in Order 451 (later clarified in Order 451-A), it adopted a modified version of the Secretary's proposal that went into effect on July 30, 1986.

The Commission found that the existing vintage pricing system for old gas was inhibiting production and creating serious market distortions. The Commission expressly found that vintage pricing of old gas was inequitable because it required consumers in some areas to pay substantially more than similarly situated consumers in other areas. 51 Fed. Reg. at 22,172, 46,766.⁴ The Commission also agreed with the Secretary's assessment of the system's inequitable effects on industrial users. 51 Fed. Reg. at 22,182-183, 46,765-766. The Commission further found that, because of the pipelines' ability to "roll in" prices of higher-cost gas supplies with those of lower-cost supplies, consumers were not realizing the benefits of artificially low prices for old gas. 51 Fed. Reg. at 22,172, 46,766. Finally, the Commission found that the maintenance of artificially low prices for old gas, which is relatively less expensive to produce, was skewing development and recovery efforts away from that gas,

⁴ The Commission noted, for example, that consumers in the Washington, D.C. area were paying their local distribution companies \$8.05/Mcf, while consumers in Kansas, whose suppliers have access to substantial old gas, were paying \$4.49/Mcf. See 51 Fed. Reg. at 22,172; see also App. 39a-40a n. 2 (Brown, J., dissenting). The Commission also found that, by substantially reducing average consumer prices, the elimination of vintage pricing of old gas would reduce prices to the vast majority of consumers, even though in the short run it might increase prices in a few regions where gas prices were artificially low. See 51 Fed. Reg. at 22,195-204.

resulting in its premature abandonment. 51 Fed. Reg. at 22,172, 46,766. The Commission conservatively estimated that, during the following decade, the elimination of vintage pricing of old gas would lead to the production of 11 Tcf of additional old gas, resulting in savings to consumers of approximately \$25 billion. 51 Fed. Reg. at 22,172, 46,766; 50 Fed. Reg. at 48,540. Accordingly, the Commission expressly found that the existing vintage pricing structure for old gas (including the specific ceiling prices applicable to pre-1974 vintages) was unjust and unreasonable. 51 Fed. Reg. at 22,182, 46,766.

The new regulatory regime for old gas created by Order 451 contained two principal elements relevant here. First, acting pursuant to its express authority under Sections 104(b)(2) and 106(c) of the NGPA, the FERC established a single ceiling price applicable to all vintages of old gas.⁵ The maximum price was set at the ceiling price for the post-1974 old gas vintage. The Commission adopted the post-1974 ceiling price because it concluded, based upon several cost studies, that this price most closely approximated the true replacement cost of gas. See 51 Fed. Reg. at 22,185, 46,768. The Commission also found that this new ceiling price was a just and reasonable price for all gas subject to Sections 104 and 106 because, *inter alia*, that price fell within the "zone of reasonableness" established by the cost studies. 51 Fed. Reg. at 22,182-185, 46,766-768. The Commission,

⁵ In so doing, the FERC did not abrogate the prior ceilings because significant conditions had to be met before a producer could collect the new maximum price. See *infra* 10-12. For that reason, the FERC referred to the new ceiling as an "alternative ceiling price." *E.g.*, 51 Fed. Reg. at 22,168. Moreover, the FERC did not eliminate the overall vintage pricing structure established in the NGPA; instead, the ceiling price for old gas remained below the ceilings applicable to the other categories of gas (*e.g.*, "new" gas) subject to price regulation under the NGPA. See, *e.g.*, 51 Fed. Reg. at 22,176-177, 46,765. The Commission merely consolidated all of the multiple vintage categories—or "subvintages"—of old gas into a single vintage category subject to a single ceiling price, thereby eliminating vintaging *within* the category of gas covered by Sections 104 and 106.

however, stated that producers would be permitted to collect a price above the old ceiling *only* if the particular contract at issue permitted a higher price. 51 Fed. Reg. at 22,204, 46,784.

Several times the Commission expressly addressed the scope of its authority under Sections 104(b)(2) and 106(c) to set a single ceiling price for all old gas. The Commission concluded that its action was authorized by Congress because "the express and unambiguous terms" of those provisions "specifically authorize the Commission to raise old gas prices, subject only to the requirement that the Commission find that the higher rates are just and reasonable within the meaning of the NGA." 51 Fed. Reg. at 22,179.⁶ The Commission also rejected suggestions by several opponents of the DOE proposal that excerpts from the Senate and House debates on the NGPA indicated a congressional intent to preclude the FERC from eliminating vintage pricing of old gas. 51 Fed. Reg. at 22,179, 46,764-765.⁷ The Commission also rejected ar-

⁶ See also 51 Fed. Reg. at 22,171 ("Congress expressly gave the Commission further authority to raise even those prices [set by Congress in Sections 104 and 106], provided the result would be just and reasonable under the NGA"); 51 Fed. Reg. at 22,174 ("[T]he NGPA authorized the Commission in its discretion to revise old, flowing gas rates—as long as it revised the rates up, not down, and as long as it determined that such revised rates were 'just and reasonable within the meaning of the Natural Gas Act'"); 51 Fed. Reg. at 46,764 ("the terms of section 104(b)(2) and 106(c) are unambiguous and specifically authorize the Commission to modify the prices and price structure of old gas, subject only to the just and reasonable standard of the NGA"); 51 Fed. Reg. at 46,764 ("authority granted to the Commission . . . to increase old gas prices . . . is too clear to admit any doubt").

⁷ For example, opponents of DOE's proposal cited a floor statement by Senator Domenici stating that elimination of vintaging "is not in this bill." 124 Cong. Rec. S28,865 (Sept. 12, 1978). However, the Commission pointed out that this statement "on its face" does not refer to "the *regulatory* revision of ceiling prices under NGPA sections 104(b) and 106(c)." 51 Fed. Reg. 22,179 (Sept. 12, 1978) (emphasis in original). See also *id.* (reproducing letter from

guments that it was in effect "deregulating" old gas: It observed that it was retaining both (a) a ceiling price applicable to that gas and (b) the authority to change that ceiling price—or even reinstate vintage pricing—if it determined that the ceiling price was no longer just and reasonable. See, *e.g.*, 51 Fed. Reg. at 22,211, 46,764-765.

As its second principal element, Order 451 requires producers to enter into negotiations with their pipeline purchasers before they can collect a higher price, even when the parties' existing contract would permit the producer to collect a price higher than the prior ceiling price. 51 Fed. Reg. at 22,204, 46,784. If the parties are unable voluntarily to negotiate a new or amended contract price, Order 451 specifies a structured "good faith negotiation" ("GFN") procedure with which producers must comply before charging a price in excess of the prior ceiling. 51 Fed. Reg. at 22,204, 46,784. To provide pipelines with additional bargaining power, Order 451 grants them the right, in response to invocation of the GFN procedure by a producer, to require the producer to renegotiate the prices previously agreed upon for any other gas (including new gas, deregulated gas and "high-cost" gas) under any contract that covers at least some old gas. 51 Fed. Reg. at 22,204-206.

The Commission also held that in those instances where parties are unable to agree on a new price for sales of old gas after compliance with the GFN procedures, abandonment of the existing service obligation by both the producer and the pipeline satisfies all the requirements of Section 7(b) of the NGA. That provision prohibits abandonment of services rendered under the Commission's jurisdiction "without the permission and approval

Sen. Domenici to FERC explaining that his statement was limited to describing what Congress was doing in the statute, not what FERC could do pursuant to the statute).

of the Commission first had and obtained, after due hearing, and a finding by the Commission . . . that the present or future public convenience or necessity permit such abandonment." 15 U.S.C. § 717(f). In accordance with the statutory requirement, the Commission found that abandonment of purchase and sale obligations following a failure to reach agreement under the GFN process would further the public convenience and necessity. 51 Fed. Reg. at 22,205. The Commission also concluded that the "due hearing" requirement of Section 7(b) "does not require that the Commission hold individual case-by-case hearings" provided that the abandonment satisfies pre-established criteria and those criteria do not turn on any disputed factual question. 51 Fed. Reg. at 22,205. In short, the Commission held that Section 7(b) permits it to authorize abandonments by administrative rule, without case-by-case adjudication. 51 Fed. Reg. at 46,787.

Finally, the Commission rejected suggestions that it should undertake to resolve the issue of take-or-pay provisions in natural gas contracts at the same time that it addressed old gas pricing.⁸ Although it acknowledged that certain take-or-pay contracts are a problem for the industry, the Commission noted that it was already addressing the take-or-pay issue in its Order 436 proceedings. 51 Fed. Reg. at 22,174-175, 46,783-784. The Commission also noted that, by permitting increased ceiling prices for old gas, Order 451 would allow pipelines to offer higher prices for old gas in exchange for producers' agreeing to renegotiate take-or-pay obligations, thereby facilitating settlement of take-or-pay disputes. 51 Fed. Reg. at 22,195-197. In short, the Commission rejected the suggestion that the take-or-pay problem was so intertwined

⁸ Since the 1950s, many pipelines entered into long-term contracts requiring them to take a specified volume of gas or, in the event the gas was not taken, to pay for the specified volume. See, e.g., *Pierce, supra*, at 15. Contracts which include such provisions are commonly referred to as "take-or-pay" contracts.

with vintage pricing of old gas as to require the Commission to provide a comprehensive solution to the take-or-pay issue in this proceeding. 51 Fed. Reg. at 46,783.

Order 451 went into effect on July 30, 1986. An informal survey of petitioners reveals that, during the intervening three and one-half years, at least 3,000 natural gas contracts have been renegotiated or terminated as a direct result of Order 451. The total volumes affected by those contracts comprise some 6.85 trillion cubic feet of natural gas, worth approximately \$13.7 billion at spot market prices as of year-end 1989. In addition, hundreds of new contracts have been executed with new customers under the authority of Order 451. Those contracts cover approximately 1.6 trillion cubic feet of old gas, worth approximately \$3.2 billion at year-end 1989 spot prices. See also *Natural Gas Price Controls: Hearing on H.R. 5195 Before the Subcomm. on Energy and Power of the House Committee on Energy and Commerce, 101st Cong., 1st Sess. 156 (Apr. 5, 1989) ("Hearing on H.R. 1595")* (post-hearing questions and answers) (as of year-end 1988, at least 1286 natural gas contracts renegotiated pursuant to Order 451).

5. On September 15, 1989, a divided panel of the court of appeals vacated the Commission's orders. The court did not dispute the findings of the Secretary of Energy and the FERC concerning the benefits that likely would result from the elimination of vintage pricing of old gas. See, e.g., App. 23a. Nor did the court overturn the FERC's conclusion that the new ceiling price applicable to all old gas is "just and reasonable" within the meaning of the NGA. Indeed, the majority agreed that the end result of the Commission's action was "arguably meritorious." App. 25a. The majority nonetheless held that the Commission had exceeded its statutory authority or acted arbitrarily and capriciously in three respects relevant here.

First, the majority held that Congress had not intended to give the Commission authority in Sections 104(b)(2) and 106(c) to set a single ceiling price for all old gas. App. 23a-24a. According to the majority, vintage pricing of old gas is too "significant [a] feature of the NGPA" to be "jettison[ed]" by the Commission. App. 25a. The panel relied for this conclusion upon its own view of the "congressional compromise" leading to the enactment of the NGPA. That view, in turn, was derived from isolated statements by individual legislators during debates over the NGPA, none of which addressed the Commission's authority under Sections 104(b)(2) and 106(c). See App. 19a-24a. The majority's opinion did not address the statutory language expressly authorizing an increase in the price ceilings, and did not consider whether any deference should be paid to the Commission's interpretation of its own organic statute.

Second, the majority also held that the Commission lacked authority under Section 7(b) of the NGA to "provid[e] for an across the board, preauthorized abandonment provision" (App. 29a), even where the Commission had determined that abandonments pursuant to the GFN procedure satisfied the public convenience and necessity requirements of the NGA. In so doing, the majority nonetheless acknowledged (App. 27a) the contrary holding of the District of Columbia Circuit in *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988), which found "'no procedural objection to the Commission's identification of circumstances, in an otherwise valid rulemaking, which automatically trigger its approval of abandonment.'" *Id.* at 1015-16 & n. 17. Furthermore, relying upon *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529 (1979), the majority held that abandonment pursuant to the GFN procedure violated Section 7(b) of the NGA because, in its view, that procedure gives the producer too much con-

trol over the abandonment decision. App. 28a-29a. In reaching this conclusion, the majority again did not address whether the Commission was entitled to any deference in its interpretation of Section 7(b).

Third, the majority held that the Commission had improperly declined to resolve the take-or-pay issue in this proceeding. App. 29a. Although it implicitly recognized that the Commission was already addressing the take-or-pay issue on remand from the D.C. Circuit's decision in *Associated Gas Distributors, supra*, the majority held that the Commission's decision not to resolve that issue in Order 451 was a "regrettable and unwarranted" refusal to deal with a crucial problem that "cannot and will not be wished away." App. 32a (citations omitted). The majority also rejected the Commission's finding that the GFN procedure to some extent would ease the take-or-pay problem because, in the majority's view, that procedure was too "one-sided." *Id.* Accordingly, the majority concluded that the "Commission's inaction on the take or pay problem is based on a rationale which is arbitrary and unsupportable." App. 33a. The majority, however, did not address the question whether the old gas pricing and take-or-pay problems were so closely related that it was unreasonable for the Commission to address the former without fully resolving the latter.

Judge Brown dissented from each of these holdings. He observed that the fundamental flaw in the majority's entire analysis was its decision to "[s]ubstitute[] its own judgment for that of the Commission on what Congress has ordained the Commission may do about the grave problems of the natural gas business." App. 37a. As to the Commission's authority to set a single ceiling price for all old gas under Sections 104(b)(2) and 106(c), Judge Brown observed that "Congress could not have been more explicit in authorizing the Commission to raise statutory ceiling prices . . . for vintage gas sales." App.

46a. As to the Commission's authority to grant abandonment on a generic basis under Section 7(b) of the NGA, Judge Brown pointed out that Section 7(b) "does not require that the Commission act on such matters only case-by-case," and he agreed with the D.C. Circuit's view in *Associated Gas Distributors* that "the law has long recognized that the Commission may act generically when the situation warrants." App. 52a. Finally, Judge Brown observed that "the take-or-pay issue is a discrete matter" that is already being addressed in other proceedings. App. 56a. He therefore decried the majority's "startling" presumption in directing the Commission, in this proceeding, "to consider, and once and for all to solve, a matter so perplexing and complex as the issue of take-or-pay contracts." App. 55a (emphasis in original).

The court of appeals denied rehearing on December 15, 1989. App. 58a. Justice White issued a temporary stay on January 10, 1990 (App. 59a), and this Court issued a stay pending certiorari on January 16, 1990 (App. 60a).

REASONS FOR GRANTING THE PETITION

This case presents three important questions concerning the scope of a court of appeals' reviewing authority over a regulatory program created by a federal agency to respond to the problems of an industry over which Congress has granted the agency regulatory jurisdiction. The first is whether the court of appeals has authority to set aside, solely on the basis of isolated and inconclusive floor statements in the legislative history, an agency's interpretation of one of its own organic statutes—in this case the FERC's interpretation of Sections 104(b)(2) and 106(c) of the NGPA—where the agency's interpretation is directly supported by the plain statutory language. The second issue is whether the court of appeals has authority to compel an agency to implement its statutory mandate—the Commission's authority under Section 7(b) of the NGA—on a case-by-case rather than a generic basis, when the agency has reasonably interpreted the

relevant statute to permit generic action. The third issue is whether the court of appeals has authority to require an agency to solve one difficult regulatory issue—the "take-or-pay" issue—as a precondition to the agency's efforts to deal with a different regulatory problem—old gas pricing—without any finding that the two issues are so intertwined as to make it arbitrary for the agency to resolve one without resolving the other.

The majority below has decided each of these important and recurring issues in a way that fails to give any deference to—and indeed undermines—the regulatory authority of the agency charged by Congress with overseeing natural gas policy. See, e.g., App. 36a-37a (Brown, J., dissenting). In so doing, the majority has placed itself in conflict with leading decisions of this Court and of the District of Columbia Circuit. Its resolution of the first issue, for example, conflicts in principle with this Court's decisions in *Chevron U.S.A. v. NRDC*, 467 U.S. 837 (1984), and *K Mart Corp. v. Cartier*, 486 U.S. 281 (1988), as well as the D.C. Circuit's decision in *National Recycling Coalition v. Reilly*, 884 F.2d 1431 (D.C. Cir. 1989), among others. The Fifth Circuit's resolution of the second issue not only conflicts in principle with *Chevron* and *K Mart*, but also squarely conflicts with the D.C. Circuit's decisions in *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), and *Kansas Power & Light Co. v. FERC*, 851 F.2d 1479 (D.C. Cir. 1988). And the court of appeals' resolution of the third issue conflicts with the D.C. Circuit's decisions in *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986), and *Neighborhood TV Co. v. FCC*, 742 F.2d 629 (D.C. Cir. 1984).

If left in place, moreover, the majority's decision to vacate Order 451 will have an enormous adverse impact on national energy policy, on the entire natural gas industry and on consumers of natural gas. It will cast into

doubt at least 3,000 supply contracts negotiated (or renegotiated) during the past three and one-half years under the auspices of that Order. It will seriously stall and, in some cases, prevent the correction of the market distortions that made Order 451 essential. In addition, it will impede the orderly transition to natural gas decontrol that Congress recently mandated in the Natural Gas Wellhead Decontrol Act of 1989, Pub. L. No. 101-60, 103 Stat. 157.

1. The first issue presented arises from the court of appeals' holding that the Commission lacks authority under Sections 104(b)(2) and 106(c) of the NGPA to set a single ceiling price for all old gas. The majority labelled the FERC's action "de facto deregulation" (App. 19a) and, relying upon a few fragments of legislative history describing the general policies of the NGPA, held that the agency had exceeded its authority under those provisions.⁹ In so holding, the majority violated at least three fundamental principles of statutory construction.

First, the majority failed to give effect to the plain language of the statute, which unambiguously authorizes the Commission to increase the ceiling price for "any natural gas [governed by Sections 104 and 106] (or category thereof, as determined by the Commission)" and permits the Commission to do so "by rule or order." 15 U.S.C. § 3314(b)(2), § 3316(c); see App. 46a (Brown, J., dissenting). The statutory language in no way pre-

⁹ On its face, this holding is at odds with this Court's statement in *Public Service Comm'n v. Mid-Louisiana Gas Co.*, 463 U.S. at 333, that the NGPA authorizes the Commission to raise ceiling prices "whenever traditional NGA principles would dictate a higher price" (emphasis added). The majority did not overturn the FERC's finding (51 Fed. Reg. at 22,185-186, 46,768-769) that the ceiling price it adopted for all categories of old gas satisfies "traditional NGA principles."

cludes the Commission from using this sweeping authority to set a single ceiling price for old gas, thereby eliminating vintage pricing within the category consisting of all old gas. See *supra* 9.¹⁰ As a matter of fact and law, that action did not constitute "de facto deregulation," as the majority asserted. App. 19a.¹¹ But regardless of how the overall effect of FERC's order is characterized, the precise action taken by the Commission unquestionably falls within the plain language of Sections 104(b)(2) and 106(c). This Court and several courts of appeals have held that, where an agency has simply followed the plain, unambiguous terms of its organic statute, a reviewing court cannot overturn the agency's interpretation. See, e.g., *Chevron, supra*, 467 U.S. at 843 (courts must give effect to unambiguously expressed intent of Congress); *Atkins v. Rivera*, 477 U.S. 154, 162 (1986) (regulation supported by plain language and thus entitled to controlling "legislative effect") (citation omit-

¹⁰ Nor is there any warrant in the statutory language for the majority's seeming suggestion that Sections 104(b)(2) and 106(c) may be "more appropriately interpreted as special relief measures to be utilized in the event that existing congressional ceiling prices become confiscatory." App. 24a n. 24. The statutory grant of authority to raise the ceiling price on "any natural gas or category thereof," and to do so "by rule or order," precludes any argument that those sections are limited to situations requiring case-by-case "special relief."

¹¹ The majority's characterization of Order 451 as "de facto deregulation" also apparently rested on the majority's view that, aside from the elimination of vintage pricing of old gas, the new ceiling price chosen by the Commission was higher than then-current spot market prices. See App. 14a & n. 15. But nothing in the NGA or the NGPA requires that ceiling prices be set below existing market prices. Nor do ceiling prices displace lower market prices agreed to by private parties. See 15 U.S.C. § 3311(b)(9). Rather, a ceiling price protects consumers from market prices that exceed the ceiling rate determined to be just and reasonable under traditional NGA standards.

ted). The decision below conflicts in principle with these decisions.

Second, the majority erred in relying upon legislative history to overturn an agency interpretation which is, at a minimum, consistent with the statutory language. The majority's decision therefore contravenes this Court's recent decision in *K Mart, supra*, which held that "[i]f the agency regulation is *not in conflict* with the plain language of the statute, a reviewing court *must* give deference to the agency's interpretation. . . ." 486 U.S. at 292 (emphasis added). The holding below also conflicts in principle with at least one recent decision of the D.C. Circuit that has faithfully applied the *K Mart* rule. See *National Recycling Coalition v. Reilly, supra*, 884 F.2d at 1435.

Third, even accepting the relevance of the legislative history relied upon by the court of appeals, the majority failed to give any deference whatever to an agency interpretation that cannot fairly be characterized as anything less than a reasonable reading of the relevant interpretive materials. As previously noted (*supra* 10-11), the Commission repeatedly and expressly analyzed both the language and the legislative history of the NGPA in determining that Sections 104(b)(2) and 106(c) authorize a single maximum ceiling price for all categories of old gas. Even if the statutory language did not clearly justify the interpretation adopted by the Commission (which it does), the legislative history is, at most, inconclusive on that precise question.¹² The court of appeals' refusal to

¹² All of the legislative history relied upon by the majority consisted of floor statements concerning either the political compromise embodied in the NGPA or the NGPA's general purpose of protecting consumers. See App. 19a-24a. Like Senator Domenici's statement discussed above (*supra* note 7), the other statements relied upon by the majority can at most be read as explanations of why Congress chose the Commission's then-existing ceiling price structure as the starting point for price regulation of gas subject to Sections 104 and 106. None of those statements addressed the

defer to the Commission in such circumstances conflicts with several decisions of this Court and other courts of appeals holding that a reviewing court must defer to an agency's construction of its own organic statute as long as it is reasonable. *Chevron, supra* (EPA regulation); *Chemical Mfrs. Ass'n v. NRDC*, 470 U.S. 116 (1985) (EPA regulation); *United States v. Riverside Bayview Homes, Inc.*, 474 U.S. 121 (1985) (Army Corps of Engineers regulation); *Ayuda, Inc. v. Thornburgh*, 880 F.2d 1325 (D.C. Cir. 1989) (INS regulation); *Union Pacific R.R. Co. v. ICC*, 867 F.2d 646 (D.C. Cir. 1989) (ICC regulation); *Knapp v. Commissioner*, 867 F.2d 749 (2d Cir. 1989) (IRS regulation); *Asociacion de Compositores y Editores de Musica LatinoAmericano v. Copyright Royalty Tribunal*, 851 F.2d 39 (2d Cir. 1988) (CRT regulation). The court of appeals' departure from these controlling principles warrants this Court's review.

2. The second issue presented arises from the majority's holding that the Commission lacks authority to allow pre-granted abandonment on a generic basis under Section 7(b) of the NGA, even when the Commission has concluded that abandonment in certain well-defined circumstances will serve the public convenience or necessity. The Commission concluded that Section 7(b) gives it broad authority to specify, in advance, conditions under which abandonment of service under contracts for old gas will be permitted without further Commission action. 51 Fed. Reg. at 22,171-172. But the majority, without any analysis of the statutory language or legislative history, held that the Commission lacks authority to enact

Commission's authority under Sections 104(b)(2) and 106(c). Moreover, the majority's reliance upon Congress's concern for consumer protection overlooks the fact that the statute protected consumers primarily by retaining the "just and reasonable" requirement of the NGA, not by setting in concrete the ceiling price structure that existed in 1978. See *supra* note 11.

"an across the board, pre-authorized abandonment provision." App. 29a.

Because the FERC's interpretation is neither unreasonable nor contradicted by the plain statutory language, the court of appeals' decision conflicts in principle with *Chevron*, *K Mart* and their progeny in other courts of appeals. See *supra* 18-21. Nothing in the language of Section 7(b) precludes the Commission from exercising its authority over abandonments in an "across-the-board" order specifying the conditions in which abandonment will be permitted. Indeed, this Court has held that pre-granted abandonment is authorized under Section 7(b) (see *FPC v. Moss*, 424 U.S. 494, 500-03 (1976)), and that the Commission may, as a general matter, implement Section 7 on a generic basis without case-by-case adjudication (*FPC v. Texaco, Inc.*, 377 U.S. 33, 40-44 (1964)).¹³

Moreover, as both the majority and dissent recognized (App. 28a, 52a), the majority's decision on this issue conflicts with decisions of the D.C. Circuit specifically holding that the Commission has broad power under Section 7(b) to provide pre-granted abandonment on a generic basis, without case-by-case adjudication. In *Associated Gas Distributors v. FERC*, *supra*, the court of appeals upheld, in part, a Commission regulation allowing pipelines, in their discretion, to abandon mandatory service whenever a pipeline's customer chooses to exercise its contract modification rights under that regu-

¹³ Nor does anything in the statutory language or elsewhere support the majority's apparent belief that the Commission improperly exercised its abandonment authority in this case because, in the majority's view, producers were given undue control over the abandonment decision. This Court's decision in *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529 (1979), relied upon by the majority as a predicate for invalidating the Commission's allowance of pre-granted abandonment, does not support the majority's position because the Commission in that case had not given any approval—pre-granted or otherwise—for the abandonment at issue there. See 442 U.S. at 533-34.

lation. See 824 F.2d at 1013-16. The court concluded that there is "no procedural objection to the Commission's identification of circumstances . . . which automatically trigger its approval of abandonment." *Id.* at 1015 n. 17. The court therefore held that this generic, "pre-granted" abandonment aspect of the regulation was an appropriate exercise of the Commission's authority under Section 7(b). *Id.*; see also *id.* at 1015-16 (same).¹⁴ The D.C. Circuit reached the same conclusion in *Kansas Power & Light Co. v. FERC*, *supra*, which upheld the FERC's authority to provide pre-granted "limited term abandonment" under Section 7(b). See 851 F.2d at 1483-86; see also *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1166 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986) (Commission has discretion to proceed by rulemaking or adjudication in administering NGA generally). This fundamental conflict between two circuits that review the lion's share of FERC cases poses a significant regulatory problem for the Commission and for the entities it regulates, a problem that can be resolved only by this Court.

3. The third issue presented arises from the court of appeals' holding that the Commission had no authority to attempt to resolve the problems associated with vintage pricing of old gas without also resolving the take-or-pay issue. As previously noted (*supra* 12-13), the Commission fully explained why it did not believe it could properly impose a comprehensive solution to the take-or-pay problem in this proceeding and why, in any event, the GFN procedure created by Order 451 would to some extent alleviate that problem. The majority disagreed, and held that the Commission's reasoning was "arbitrary and unsupportable." App. 33a. In so holding, the court of appeals not only substituted its own judgment for the ex-

¹⁴ The D.C. Circuit also squarely rejected the view (see *supra* note 13) that generic, pre-granted abandonment is impermissible because it allegedly places the abandonment decision in the hands of private parties. See 824 F.2d at 1016.

pert judgment of the Commission as to the likely effect of Order 451, but also ignored the Commission's ongoing efforts to resolve the take-or-pay issue in another proceeding.¹⁶

Most important, however, the court of appeals applied the wrong legal standard in determining that the take-or-pay problem had to be solved as a precondition to the Commission's efforts to deal with the problem of old gas pricing. The usual standard for determining the lawfulness of agency action is, of course, whether the explanation the agency has given for its decision is "reasoned." See, e.g., *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 412-17 (1971). But a more deferential standard generally applies in determining the lawfulness of agency inaction because an agency has the widest discretion over the proper ordering of its regulatory priorities. E.g., *Heckler v. Chaney*, 470 U.S. 821, 831-32 (1985); *Vermont Yankee Nuclear Power Corp. v. NRDC*, 435 U.S. 519, 543-45 (1978).

In accordance with that principle, the D.C. Circuit has consistently held that, regardless of the explanation an agency gives, it may not be required to take action on one matter in a proceeding initiated to deal with a different matter unless the court of appeals finds that the two issues are so "inextricably related" that the second issue cannot rationally be resolved without also resolving the first. E.g., *Neighborhood TV Co. v. FCC*, *supra*, 742 F.2d at 642 (agency has "discretion to defer resolution of issues raised in a rulemaking so long as the issues decided are not 'inextricably related to the issues de-

¹⁶ As previously noted, the Commission is addressing the take-or-pay issue in its Order 436/500 proceeding. See *American Gas Ass'n v. FERC*, 888 F.2d 136 (D.C. Cir. 1989); *Tennessee Gas Pipeline Co. v. FERC*, 885 F.2d 937 (D.C. Cir. 1989); App. 56a (Brown, J., dissenting). Obviously, a requirement that the Commission also resolve the take-or-pay issue in this proceeding not only will cause a duplication of effort by the Commission and the parties, but also could lead to directly conflicting decisions by two courts of appeals.

ferred'") (quoting *ITT World Communications v. FCC*, 725 F.2d 732, 754 (D.C. Cir. 1984)); see also *Western Union Int'l v. FCC*, 673 F.2d 539, 541 (D.C. Cir. 1982). As that circuit has held, "for the reviewing court to maintain its proper function, it cannot require agencies to solve all problems that may be related to a particular decision at the same time." *Wisconsin Gas Co. v. FERC*, 770 F.2d at 1159-60 (applying "inextricably related" standard in declining to require FERC to address take-or-pay problem in connection with "minimum bill" problem).¹⁶

That, however, is exactly what the majority has done in its "audacious" requirement that the Commission solve the take-or-pay problem as a prerequisite to eliminating the distortions created by vintage pricing of old gas. See App. 56a (Brown, J., dissenting). The majority imposed that obligation without any finding that the two issues were so inextricably related as to make it unreasonable to resolve one without the other, and no such finding could be made on the present record. See *id.* (noting that "take-or-pay issue is a discrete matter").¹⁷ The court of

¹⁶ This Court applied the same general principle in *FPC v. Sunray DX Oil Co.*, 391 U.S. 9, 49-52 (1968), which affirmed the discretion of the FPC to address take-or-pay issues in pipeline proceedings rather than producer proceedings.

Obviously, the "inextricably related" standard does not preclude a reviewing court from holding that an agency's explanation for refusing to deal with the second problem is arbitrary, and remanding for further consideration. But a reviewing court may not require the agency to resolve the second issue, as the majority did here, without a finding that the two issues are so inextricably related that they must be dealt with simultaneously.

¹⁷ The closest the majority came to such a finding was its assertion that "the prospect for exacerbating the take or pay problem runs rampant throughout the provisions of Order No. 451." App. 33a. But even if this bald assertion were correct (which it is not, see App. 56a (Brown, J., dissenting)), the fact that a regulatory program designed to resolve one problem might "exacerbate" another problem does not mean that the first problem cannot rationally be resolved without also resolving the second. In applying the "inextricably related" standard, the D.C. Circuit has repeatedly rejected

appeals' decision therefore conflicts with the D.C. Circuit's jurisprudence on this important question of administrative law. If left in place, moreover, the majority's decision creates a risk that the Fifth Circuit will hamstring the Commission and other federal agencies with similarly burdensome preconditions to their efforts to resolve discrete regulatory problems. Only this Court can resolve the circuit conflict and remove the risk of improper interference with regulatory priorities created by the decision below.

4. Aside from the doctrinal importance of the questions presented, an additional reason to grant the petition is the dramatic impact the decision below will have on the entire natural gas market.

First, the court of appeals' decision, if left in place, will cast into doubt at least 3,000 gas supply contracts—and potentially any settlements of which they are a part—that have been negotiated or renegotiated since Order 451 went into effect. Order 451 was a key element in a comprehensive regulatory program designed to reduce or eliminate severe distortions following the partial decontrol mandated by the NGPA. Hundreds of parties, including both pipelines and producers, have utilized that order to reach comprehensive settlements of contract disputes, settlements which overwhelmingly led to lower consumer prices. The DOE's Assistant Secretary for Fossil Energy conservatively estimated that, at year-end 1988, 1,286 contracts had been renegotiated under Order 451, a rate of approximately 400 every six months since Order 451 went into effect. See *Hearing on H.R. 1595* at 156. A more recent informal survey of petitioners, reflecting data through year-end 1989, indicates that at least

the notion that the mere "exacerbation" of a separate regulatory problem is alone sufficient to require an agency to address that problem. See, e.g., *Neighborhood TV Co.*, *supra*, 742 F.2d at 643 (even though FCC licensing of low power TV stations interfered with sheriff's radio communications, agency could defer resolution of that problem to another proceeding).

3,000 contracts have been renegotiated or terminated as a direct result of Order 451, affecting approximately 6.85 trillion cubic feet of gas worth approximately \$13.7 billion. See *supra* 13. In short, "three years of 451 renegotiations, revisions and abandonments . . . are now in limbo" as a consequence of the holding below. *Unscrambling the 451 Egg*, Natural Gas Intelligence 2 (Sept. 18, 1989); see also *Court Ruling Could Force Invalidation of Gas Pacts*, The Oil Daily 1 (Sept. 19, 1989).

The decision below also creates a significant risk that much of the approximately 1.6 trillion cubic feet of gas contracted to new customers pursuant to Order 451 (see *supra* 13) will have to be redirected to the original customers, thereby forcing the new customers to seek gas from other sources. See *Hearing on H.R. 1595* at 156-59; *Unscrambling the 451 Egg*, at 3. The net effect of the court's decision, therefore, is to cast a shadow over "major components of the market restructuring" that has occurred as a result of the Commission's orders, thereby leaving "buyers and sellers alike unsure of future production and supply." *Court Leaves Gas Industry Twisting in the Wind*, Natural Gas Intelligence 1 (Sept. 25, 1989).

Second, the panel's decision will stall or prevent the correction of the very market distortions that gave rise to the Commission's orders. As previously noted, the Commission expressly found (and the court of appeals did not dispute) that Order 451 was necessary to induce the production of approximately 11 trillion cubic feet of additional old gas—gas that otherwise would not have been produced under the then-existing regulatory system. That amount of gas is more than 50 percent of the Nation's current annual gas consumption. To be sure, the Natural Gas Wellhead Decontrol Act of 1989 (Pub. L. No. 101-60, 103 Stat. 157) ("Decontrol Act") may facilitate the eventual production of some of that gas by eliminating all NGPA price ceilings on or before January 1, 1993.

But the panel's decision will undoubtedly delay, and in many cases preclude, the recovery and delivery of a substantial portion of that gas. It will therefore delay and significantly reduce the \$25 billion in consumer savings that the Commission found would be generated by Order 451.

Third, the Fifth Circuit's decision will impair the implementation of the Decontrol Act. The legislative history of that Act indicates that the Commission's pro-competitive initiatives, including Order 451, were "essential" to many legislators' decisions to complete the decontrol process initiated by the NGPA because they wanted the transition to deregulated pricing to be gradual, not abrupt. H.R. Rep. No. 29, 101st Cong., 1st Sess. 6 (1989), reprinted in 1989 U.S. Code Cong. & Admin. News 51, 56; S. Rep. No. 39, 101st Cong., 1st Sess. 5-6 (1989). Many members of Congress therefore strongly urged the Commission and the courts "to retain and improve this competitive structure in order to maximize the benefits" of the new Act. *Id.*; see also 135 Cong. Rec. H3,661 (daily ed. July 12, 1989). The reasons for this recommendation are obvious: If substantial regulation-induced market distortions are in place when full decontrol becomes effective, decontrol could well produce significant (even if only temporary) dislocation and uncertainty. By removing many of those distortions, Order 451 will facilitate the gradual transition to decontrol mandated by the Decontrol Act. The court of appeals' decision to dismantle Order 451 will impede that transition and undermine Congress's objective.¹⁸

¹⁸ In unsuccessfully opposing petitioners' application for a stay, respondents United Distribution Companies, *et al.* argued that the Decontrol Act substantially eliminates any need for review of the decision below. That argument is incorrect for at least three reasons, two of which reflect the fact that Order 451 is the cornerstone of a regulatory system that Congress built upon in enacting

* * *

In sum, the court of appeals has gone well beyond merely setting aside a comprehensive and balanced solution to one set of fundamental problems in the regulation of natural gas. It has also adopted an approach to judicial review that fails to give any deference to the FERC's view of its regulatory authority and flatly conflicts with several leading decisions of this Court and of the D.C. Circuit. Given the large number of FERC appeals that are taken to the Fifth Circuit, the approach adopted by the court of appeals will significantly impair future attempts by the FERC to provide solutions to other energy problems. In addition, the court of appeals' decision will adversely affect billions of dollars worth of natural gas, tens of millions of gas consumers, scores of pipelines, producers, and local gas distributors, and Congress's own recent efforts to facilitate an orderly and gradual transition to full wellhead decontrol. Review by this Court is essential to correct both the doctrinal mischief and the economic havoc created by the court of appeals' decision.

the Decontrol Act: *First*, the Decontrol Act cannot avert the severe disruption and uncertainty in natural gas markets that will be created if the Fifth Circuit's decision remains in place. See *supra* 26-28. The Decontrol Act has no effect on the trillions of cubic feet of gas covered by Order 451 that were purchased between July 1986 (when Order 451 became effective) and July 1989 (when the Decontrol Act was enacted). Moreover, substantial quantities of gas for which wellhead price regulation will be eliminated by the Decontrol Act on January 1, 1993, will continue to be subject to Order 451 until that date. *Second*, even beyond 1993, the Decontrol Act will not alleviate distortions in the pricing of gas sold under a large group of contracts covered by Order 451, namely, long-term contracts which allow price changes only by regulatory directive (*e.g.*, certain contracts with "area rate" clauses). *Third*, the broad legal issues presented in this petition—of judicial deference to the Commission's interpretations of its organic statutes, of the Commission's ability to exercise its abandonment authority on a generic basis, and of the Commission's ability to control its regulatory priorities—will not be affected by the Decontrol Act.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

JAY G. MARTIN
GENE ANN HERRIN
MOBIL NATURAL GAS INC.
12450 Greenspoint Drive
Houston, Texas 77060
(713) 775-2000

CHARLES M. DARLING, IV
STEVEN C. TEICHLER
BAKER & BOTTS
555 13th Street, N.W.
Suite 500 East
Washington, D.C. 20004
(202) 639-7700

REX E. LEE *
EUGENE R. ELROD
CARTER G. PHILLIPS
GENE C. SCHAEER
JEFFREY T. GREEN
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 429-4000

* Counsel of Record

(Additional Counsel Listed on Next Page)

March 14, 1990

Of Counsel:

WILLIAM H. EMERSON
P. O. Box 87703
Chicago, Illinois 60680

and
STEPHEN A. HERMAN
DAVID G. NORRELL
KIRKLAND & ELLIS
655 15th Street, N.W.
Suite 1200
Washington, D.C. 20005
Attorneys for
Amoco Production Co.

MARIO M. GARZA
P. O. Box 1330
Houston, Texas 77251
and
R. GORDON GOOCH
TRAVIS & GOOCH
1100 Fifteenth Street, N.W.
Suite 1200
Washington, D.C. 20005
Attorneys for
Anadarko Petroleum
Corporation

HARRIS S. WOOD
KATHLEEN E. MAGRUDER
NORMA J. ROSNER
P. O. Box 2819
Dallas, Texas 75221
and
HARRY E. BARSH, JR.
CAMP, BARSH, BATES & TATE
2550 M Street, N.W.
Suite 275
Washington, D.C. 20037
Attorneys for
ARCO Oil and Gas Company

GARY J. CELESTINO
BRIAN J. BELL
P.O. Box 218330
Houston, Texas 77218
Attorneys for
Ashland Exploration, Inc.

GERALD P. THURMOND
1301 McKinney
Suite 2200
Houston, Texas 77010
and

DAVID J. EVANS
DANIEL JOHN REGAN, JR.
PILLSBURY, MADISON & SUTRO
1667 K Street, N.W.
Suite 1100
Washington, D.C. 20006
Attorneys for
Chevron U.S.A. Inc.

ERNEST J. ALTGELT, III
BROCK G. RIDGEWAY
P. O. Box 2197
McLean Building
Houston, Texas 77252
Attorneys for
Conoco Inc.

C. ROGER HOFFMAN
DOUGLAS W. RASCH
P. O. Box 2180
Houston, Texas 77251-2180
Attorneys for
Ezzon Corporation

GERALD M. BENDO
TONI D. HENNIKE
Fountain Place
1445 Ross at Field
Dallas, Texas 75202

Attorneys for
Hunt Oil Company

ROBERT C. PLATT
1250 Connecticut Ave., N.W.
Suite 800
Washington, D.C. 20036
Attorney for
Independent Petroleum
Association of America

ROBERT C. MURRAY
P. O. Box 3128
Houston, Texas 77253
and

THOMAS G. JOHNSON
JACKSON & WALKER
1100 Louisiana
Suite 4200
Houston, Texas 77002-5219

Attorneys for
Marathon Oil Company

JOHN B. CHAPMAN
SYLVIA MCCORMACK
P. O. Box 2967
Houston, Texas 77252-2967
and

JOHN K. McDONALD
BUTLER & BINION
1747 Pennsylvania Ave., N.W.
Suite 900
Washington, D.C. 20006
Attorneys for
Pennzoil Company

JOHN L. WILLIFORD
LARRY PAIN
LUKE A. MICKUM
1256 Adams Building
Bartlesville, Oklahoma 74004
Attorneys for
Phillips Petroleum Company
and Phillips 66 Natural Gas
Company

ROBERT A. MILLER, JR.
12596 W. Bayaud
Suite 400
Lakewood, Colorado 80228
Attorney for
Plains Petroleum Company

JOHN J. WOLFE
200 Crescent Court
Suite 300
Dallas, Texas 75201
Attorney for
Rosewood Resources, Inc.

MICHAEL L. PATE
P. O. Box 300
Tulsa, Oklahoma 74102
Attorney for
OXY USA Inc.

CHARLES J. MCCLEES, JR.
JAMES A. RUOFF
Room 4716
One Shell Plaza
P. O. Box 2463
Houston, Texas 77252
and

THOMAS G. JOHNSON
JACKSON & WALKER
1100 Louisiana
Suite 4200
Houston, Texas 77002-5219

Attorneys for
Shell Offshore Inc. and
Shell Western E&P Inc.

THOMAS B. DEAL
P. O. Box 2880
Dallas, Texas 75221-2880
Attorney for
Oryx Energy Company
(formerly Sun Exploration
and Production Company)

DEE H. RICHARDSON
ERNEST L. KUBOSH
4635 Southwest Freeway
Suite 900
Houston, Texas 77027

Attorneys for
Union Oil Company
of California

KERRY R. BRITTAIN
ALAN W. TOMME
Mail Station No. 4010
P. O. Box 7
Fort Worth, Texas 76101

Attorneys for
Union Pacific Resources Co.

RALPH J. PEARSON
P. O. Box 52332
Houston, Texas 77052

Attorney for
Tezaco Inc.

TIMOTHY JACQUET
P. O. Box 2120
Houston, Texas 77251

Attorney for
Union Texas Petroleum
Corporation

APPENDICES

1a

APPENDIX A

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 86-4940

MOBIL OIL EXPLORATION AND PRODUCING
SOUTHEAST, INC., *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

Sept. 15, 1989

Dissenting Opinion Sept. 26, 1989

Daniel F. Collins, Fern L. McGovern, Washington,
D.C., for ANR Pipeline Co.

David J. Muchow, Roger B. Cooper, American Gas
Ass'n, Arlington, Va., for American Gas Association.

Mark C. Darrell, William T. Miller, Susan N. Kelly,
Washington, D.C., for American Public Gas Ass'n.

William T. Benham, Chicago, Ill., for Amoco Produc-
tion Co.

R. Gordon Gooch, Washington, D.C., for Anadarko Pe-
troleum Corp.

Harris S. Wood, Norma J. Rosner, Dallas, Tex., for
Arco Oil & Gas Co.

Michael E. Riddick, Platt W. Davis, III, David T. Andril, Washington, D.C., J. David Garrett, Shreveport, La., for Arkla Energy Resources.

Frederick Morning, M. Lisanne Crowedye, Crowell & Moring, Washington, D.C., for Associated Gas Distributors.

Kerry B. Brittain, Ft. Worth, Tex., for Champlin Petroleum Co.

James B. Atkin, David J. Evans, Washington, D.C., for Chevron U.S.A. Inc.

Michael L. Pate, Cities Service Oil & Gas Corp., Tulsa, Okl., for Cities Service Oil & Gas Corp.

Daniel F. Collins, Donald C. Shepler, Fern L. McGovern, Shepler & McGovern, Washington, D.C., for Colorado Interstate Gas Co.

Ernest J. Altgelt, III, Conoco, Inc., Houston, Tex., for Conoco, Inc.

Craig R. Burgraff, Robert P. Haynes, III, Harrisburg, Pa., for Consumer Advocate of Penn.

Richard C. Green, Hogan & Hartson, Washington, D.C., for El Paso Natural Gas Co.

John T. Miller, Jr., Washington, D.C., for Elizabethtown Gas Co.

Douglas W. Rasch, Exxon Corp., Houston, Tex., for Exxon Corp.

Jerome Feit (argued), Sol., F.E.R.C., John Conway, Atty., Washington, D.C., for F.E.R.C.

Robert A. Jablon, Scott H. Strauss, Washington, D.C., for Ft. Pierce Utilities Authority.

Richard M. Merriman, Peyton G. Bowman, III, Reid & Priest, Washington, D.C., for Gen. Service Customer Group.

Robert C. Platt, Washington, D.C., for Independent Petroleum Ass'n.

John H. Cheatham, III, Edward B. Myers, Washington, D.C., for Interstate Natural Gas.

J. Richard Tiano, John Myler, Mary Ann Walker, Washington, D.C., Robert C. McHugh, Thomas J. Carroll, III, KN Energy, Inc., Lakewood, Colo., for KN Energy, Inc.

David P. Mudrick, David Black, John K. Rosenberg, Martin J. Bregman, Kansas Power & Light Co., Topeka, Kan., William T. Harkaway, Harvey L. Reiter, Washington, D.C., for Kansas Power & Light Co.

Kenneth J. Neises, Laclede Gas Co., St. Louis, Mo., for Laclede Gas Co.

George H. Rothschild, Jr., Marathon Oil Co., Houston, Tex., Kevin M. Sweeney, Washington, D.C., for Marathon Oil Co.

Thomas C. Gorak, Baltimore, Md., for Maryland People's Counsel.

Glenn W. Letham, Kenneth M. Albert, Washington, D.C., for Memphis Light, Gas, etc.

Jeffrey M. Petrash, James H. Holt, Washington, D.C., for Michigan Consol. Gas Co.

James C. Mordy, Morrison, Hecker, Curtis, Kuder & Parrish, Kansas City, Mo., for Midwest Energy, Inc.

Christopher K. Sandberg, St. Paul, Minn., for Minnesota Dept. of Public Services.

John Wyeth Griggs, Birch, Horton, Bittner, Pestinger & Anderson, Washington, D.C., Andrew J. Snider, Asst. Gen. Counsel, Jefferson City, Mo., for Missouri Public Service Com'n.

Kevin M. Sweeney, Carroll L. Gilliam, J. Paul Douglas, Washington, D.C., Robert D. Hawroth, Jay G. Martin, Houston, Tex., for Mobil Oil Corp., et al.

Paul E. Goldstein, Paul W. Malloy, Jerome Mrawca, Andrea Studzinski, Lombard, Ill., for Natural Gas Pipeline Co. and United Gas Pipe Line Co.

George J. Meiburger, Peter C. Lesch, Frank X. Kelly, Gallagher, Boland, Meiburger & Brosnan, Washington, D.C., for Northern Natural Gas Co.

Gene R. Sommers, Minneapolis, Minn., for Northern States Power Co.

Thomas C. Gorak, Md. Office of People's Counsel, Baltimore, Md., for Nat. Ass'n. of State Utility Consumer Avo.

John H. Cary, Northwest Central Pipeline Corp., Tulsa, Okl., for Northwest Central Pipeline Corp.

Margaret Ann Samuels, Anne L. Hammerstein, Office of Consumers' Counsel, Columbus, Ohio, for Office of Consumers' Counsel, State of Ohio.

Lindsey How-Dowling, Steven F. Greenwald, San Francisco, Cal., for Pacific Gas & Electric Co.

Raymond N. Shibley, Brian D. O'Neill, Washington, D.C., for Panhandle Eastern Pipeline & Truckline Gas.

Richard E. Powers, Jr., Charles E. Suffling, John M. Hopper, Jr., Washington, D.C., for Pennzoil Co.

Thomas M. Patrick, Chicago, Ill., for Peoples Gas Light & Coke Co.

John L. Williford, Larry Pain, Jennifer A. Cates, Attorneys, Phillips Petroleum Co., Bartlesville, Okl., for Phillips Petroleum Co., et al.

Eugene R. Elrod, Donald H. Smith, Washington, D.C., Robert A. Miller, Jr., Plains Petroleum Co., Lakewood, Colo., for Plains Petroleum Co.

Edward J. Grenier, Jr., Gail S. Gilman, Sutherland, Asbill & Brennan, Washington, D.C., for Process Gas Consumers, et al.

John P. Gregg, Washington, D.C., for Public Service Com'n of Dist. of Columbia.

Richard A. Solomon, David D'Alessandro, Wilner & Scheiner, Washington, D.C., for Public Service Com'n of N.Y.

James R. Lacey, Newark, N.J., for Public Service Elec. & Gas Co.

Janice E. Kerr, J. Calvin Simpson, Michael B. Day, San Francisco, Cal., for Public Utilities Com'n of Cal.

Thomas G. Johnson, Gen. Atty., c/o Shell Oil Co., Houston, Tex., for Shell Offshore, Inc. & Shell Western E & P, Inc.

Glen J. Sullivan, David L. Huard, Douglas Ken Porter, E.R. Island, Los Angeles, Cal., for Southern Cal. Gas Co.

William I. Harkaway, Steven J. Kalish, Washington, D.C., for Southwest Gas Corp.

Don L. Keskey, Henry J. Boynton, Asst. Attys. Gen., Lansing, Mich., for State of Mich. and Michigan Pub. Serv. Com'n.

Charles L. Spann, Dallas, Tex., for Sun Exploration & Prod. Co.

Robert W. Gee, Phyllis G. Rainey, Attys., Tenneco Oil Co., Houston, Tex., for Tenneco Oil Co.

Vincent F. Ewell, Jr., Houston, Tex., for Tennessee Gas Pipeline.

Robert W. Baker, Tenngasco Corp., Houston, Tex., for Tenngasco Corp.

Ralph J. Pearson, Jr., Karen A. Berndt, Attys., Texaco, Inc., Houston, Tex., for Texaco, Inc.

Judy M. Johnson, Vice Pres. & Gen. Counsel, Texas Eastern Transmission Corp., Houston, Tex., for Texas Eastern Transmission Corp.

Clayton G. Smith, Atty., Transcontinental Gas Pipe Line, Houston, Tex., Thomas F. Ryan, Jr., Robert G. Hardy, Andrews & Kurth, Washington, D.C., for Transcontinental Gas Pipe Line Co.

Morton L. Simons, Simons & Simons, Washington, D.C., for Union Gas Systems, Inc.

Albert Sylvia, III, Los Angeles, Cal., for Union Oil Co. of Cal.

Roberta L. Halladay (argued), Morgan, Lewis & Bockius, Washington, D.C., C. William Cooper, Sewickley, Pa., for United Distribution Companies.

Michael E. Small, Gregory Grady, Charles M. Darling, Washington, D.C., for Williams Natural Gas Co.

Petitions for Review of Orders of the Federal Energy Regulatory Commission.

Before CLARK, Chief Judge, BROWN and JOHNSON, Circuit Judges.

JOHNSON, Circuit Judge: *

Petitioners, joint opponents of the Federal Energy Regulatory Commission's Order Nos. 451 and 451-A, seek review by this Court contending that the Commission exceeded the scope of its authority in promulgating those Orders. For the reasons cited herein, we agree and vacate the orders complained of.

I. AN HISTORICAL PERSPECTIVE

The instant controversy finds its genesis in the enactment of the Natural Gas Act of 1938 (NGA),¹ which was Congress' first attempt to provide a workable system of natural gas regulation. Congress, aware of the regula-

* Judge Brown reserves the right to file a further concurring or dissenting opinion pursuant to Court Policy 15(J).

¹ Pub. L. No. 75-688, 52 Stat. 821 (codified in 15 U.S.C. §§ 717-717w (1976)).

tory gas precipitated by a lack of state power to control interstate pipelines, undertook efforts to bridge that gap through the enactment of the NGA. The regulatory policies of the NGA, which were basically designed to deal with what was considered the burgeoning monopoly power of the pipelines,² had significant effects on the future regulation of the nation's natural gas industry.

The provisions of the NGA called for cost based price ceilings for the "sale in interstate commerce of natural gas for resale."³ Section 4(a) of the NGA⁴ provided that the standard for first sale natural gas pricing would be a "just and reasonable" rate calculated in accordance with traditional public utility method principles. The public utility pricing methodology, which allowed pipelines to recover only their actual costs plus a reasonable rate of return and depreciation, was a consumer oriented approach designed to preclude the possibility of pipeline windfalls. In essence, Congress had, through the pricing provisions of the NGA, chosen consumer protection as the overriding objective in the implementation of the nation's first natural gas regulatory scheme. *See, e.g., FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610, 64 S.Ct. 281, 291, 88 L.Ed. 333 (1944) ("The primary aim of [the NGA] was to protect consumers against exploitation at the hands of natural gas companies").

The Federal Power Commission (the "Commission")⁵ was authorized to administer the NGA's provisions. While

² For a series of Federal Trade Commission Reports documenting the alleged abuses by natural gas companies, including monopoly control over consumer prices, *see* Federal Trade Comm'n, Utility Corporations, S. Doc. No. 92, 70th Cong., 1st Sess. *See also* S. Res. 83, 70th Cong., 1st Sess., 69 Cong. Rec. 3054.

³ NGA § 1(b), 15 U.S.C. § 717(b) (1976).

⁴ 15 U.S.C. § 717(a) (1976).

⁵ Throughout this opinion, the term "Commission" will refer to the Federal Power Commission and its successor, the Federal Energy Regulatory Commission.

the Commission initially construed the provisions of the NGA to regulate gas sales at the downstream end of interstate pipelines,⁶ the Supreme Court, in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 74 S.Ct. 794, 98 L.Ed. 1035 (1954), directed the Commission to regulate pricing upstream at the wellhead. In so doing, the Supreme Court interpreted the NGA as "[giving] the Commission jurisdiction over the rates of *all* wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company." *Id.* at 682, 74 S.Ct. at 799 (footnote omitted) (emphasis supplied).

Responding to the Supreme Court's directive in *Phillips*, the Commission began regulating rates for individual producers in accordance with the NGA's just and reasonable standards through the application of traditional public utility rate setting principles. Because the Commission initially undertook this task by calculating producer rates on an individualized basis, the Commis-

⁶ The Supreme Court, in *Public Service Comm'n of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 103 S.Ct. 3024, 77 L.Ed.2d 668 (1983), explained that the NGA

authorized rates that were "just and reasonable" within the meaning of [the NGA] by examining whatever costs the pipeline had incurred in acquiring and transporting the gas to the consumer. If the pipeline itself or a pipeline affiliate had produced the gas, the actual expenses historically associated with production and gathering were included in the rate base to the extent proper and reasonable. However, if the pipeline had purchased the gas from an independent producer, the Commission did not take jurisdiction over the producer to evaluate the reasonableness of its rates; it only considered the broad issue of whether, from the pipelines' perspective, the purchase price was "collusive or otherwise improperly excessive."

Id. at 328, 103 S.Ct. at 3030 (citations omitted) (emphasis supplied).

sion soon became unable to keep up with its workload.⁷ Accordingly, the Commission shifted from its individualized rate setting scheme to an area rate regulation system whereby producer rates were calculated on the basis of a particular region's average production costs, average investment costs, and average rates of return. See Statement of General Policy 61-1, 24 F.P.C. 818 (1960). While the Commission's new regional system preserved the earlier method of calculating prices on the basis of historical costs rather than projected costs, it established a two-tiered rate structure for each area regulated. The area rates, one for "old gas" and one for "new gas" were governed by a Commission set control date. Wells drilled after the control date were priced at a "new gas" rate and wells drilled before the control date were priced at an "old gas" rate. The new pricing system, known as "vintage pricing" or "vintaging"⁸ was based on the theoretical assumption that for gas that was already flowing, "price could not serve as an incentive, and since any price above average historical costs, plus an appropriate return, would merely confer windfalls." *Permian Basin Area Rate Cases*, 390 U.S. 747, 797, 88 S.Ct. 1344, 1375, 20 L.Ed.2d 312 (1968). The Supreme Court, in the *Permian Basin Area Rate Cases*, 390 U.S. 747, 88 S.Ct. 1344, 20 L.Ed.2d 312 (1968), affirmed the Commission's

⁷ The Commission estimated that it would be unable to finish its 1960 workload until 2043. See Statement of General Policy 61-1, 24 F.P.C. 818 (1960).

⁸ Under vintaging, natural gas is priced with reference to the date of the sales contract, or as has been the case lately, the date when the gas was first produced. The rate for older vintages is lower than the rate for later vintages. Logically, the difference is explained by the fact that production and development costs were lower when the earlier gas was discovered. The purpose of vintaging is to provide producers with a reasonable, but not excessive return on their sunk investment. See, e.g., Opinion No. 770, "National Rates for Jurisdictional Sales of Natural Gas," 56 F.P.C. 509, 521 (1976).

area rate system concluding that not only did the Commission's new regional system yield reasonable prices, but that the Commission's prior individualized approach had become unworkable. *Id.* at 777, 88 S.Ct. at 1365.

With the implementation of the two-tiered vintage pricing system, the Commission hoped that its higher "new gas" prices would stimulate the development of new gas reserves while at the same time ensuring continued consumer protection through lower "old gas" prices. Significantly, however, the Commission was empowered only to regulate the wellhead price of natural gas to be sold for resale in the *interstate* market. Rates on the *intrastate* market on the other hand remained largely uncontrolled. The result of interstate only regulation was that prices for gas sold on the interstate market were kept relatively low while prices for gas sold on the intrastate market continually rose as demand rose. Natural gas shortages increased as a result of sharp pipeline delivery curtailments on the lower priced interstate market.

In an effort to relieve the disturbing shortages, the Commission abandoned the area rate pricing system in favor of a national rate pricing approach. See *Southern Louisiana Area Rate Proceeding*, 46 F.P.C. 86, 110-111 (1971); *National Rates for Natural Gas*, 51 F.P.C. 2212 (1974) (Opinion No. 699). The new national rate approach applied to gas produced from all wells that were drilled after January 1, 1973, and applied across the board to independent producers, pipelines and pipeline affiliates. Additionally, the Commission, in order to ameliorate production shortages, abandoned its prior pure historical cost based approach in favor of an incentive price approach in order to stimulate development of new reserves. *National Rates for Natural Gas*, 52 F.P.C. 1604, 1615-18 (1974) (Opinion No. 699-H). Concurrently, the Commission abandoned, at least temporarily, vintage pricing.

Albeit well intentioned, the Commission's efforts to correct shortages on the interstate natural gas market were inadequate. Recognizing the need to take action, and after some nineteen months of heated debate between the members of Congress who favored deregulation and those who did not,⁹ Congress enacted the Natural Gas Policy Act (NGPA).¹⁰ In the NGPA, Congress gave the Commission power to do what the Commission had been unable to do before—regulate wellhead prices in the intrastate market. As a compromise measure, the NGPA contemplated the eventual deregulation of certain categories of natural gas, provided for the gradual price increase of all categories of natural gas, and authorized Commission regulation of natural gas transportation between interstate and intrastate markets.¹¹

The NGPA established a pricing system which was based, in part, on the genre of the gas to be regulated, namely, "old gas," "new gas," and "high cost gas." More specifically, the NGPA set price ceilings on gas depend-

⁹ Attempts by those who favored deregulation to enact laws which effect deregulation were numerous, but unsuccessful. The most serious attempt was made during the 84th Congress when both Houses passed H.R. 6645, which would deregulate wellhead prices. 101 Cong. Rec. 11930 (1955) (House vote); 102 Cong. Rec. 2096 (1956) (Senate vote). Then President Eisenhower vetoed the bill on grounds totally unrelated to the merits of deregulation. See D. Eisenhower, Pub. Papers 256 (1956).

¹⁰ 92 Stat. 3350, (codified in 15 U.S.C. § 3301 *et seq.* (1982)). See *Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. 409, 420, 106 S.Ct. 709, 715, 88 L.Ed.2d 732 (1986) (Although in enacting the NGPA, Congress moved towards a less regulated natural gas market, Congress expanded in some respects federal control.)

¹¹ The NGPA specified the maximum lawful price which could be charged for "first sales" of gas produced in each of eight enumerated categories of gas. The NGPA also prescribed rules for raising prices each month on "first sale" gas and for passing those price increases down to ultimate purchasers.

ing on when or how the gas was produced. Newer, harder to produce gas commanded higher price ceilings while older gas already under production was pegged with lower price ceilings. Congress had, through the pricing provisions of the NGPA, sought to balance the interest of the consumer by keeping old gas prices low while at the same time encouraging the development of new reserves through incentive pricing.¹²

Recognizing that for certain categories of gas, the new NGPA price ceilings might be set too low, Congress provided an escape valve for the Commission. NGPA sections 104, 106 and 109 authorized the Commission to raise prices in accordance with traditional NGA "just and reasonable" principles for three particular categories of gas. Similarly, section 110(a)(2) appeared to give the Commission the authority to raise price ceilings for the other five categories of gas enumerated in the NGPA. Congress, however, declined to give the Commission the authority to mandate lower price ceilings than those provided for by the NGPA.

The effects of the NGPA were bittersweet. Clearly, the NGPA's regulatory scheme ameliorated, if not eliminated, the disparity between the interstate and intrastate natural gas markets which existed prior to the passage of the Act. Also, the increased prices provided by the NGPA stimulated increased production of natural gas by providing producers with the incentive to develop additional natural gas supplies. Accordingly, natural gas shortages were alleviated. On the down side, the NGPA's

¹² This Court has previously recognized this delicate balance of interests struck by Congress. In *Pennzoil Co. v. FERC*, 645 F.2d 360 (5th Cir. 1981), we noted that the NGPA "adopted an incentive-based approach to rate-setting for gas production, providing substantially higher prices for 'new' gas than was currently available. At the same time, the NGPA provided consumer protection by maintaining lower prices on flowing gas, providing only limited future price deregulation in 1985, and extending price controls to intrastate sales of gas." *Id.* at 367 (footnotes omitted).

new pricing system created market distortions because it priced categories of natural gas at various levels. Additionally, during the gas shortages of the 1970s and early 1980s, many pipelines entered into take or pay contracts which commanded high prices for large volumes of gas. Later, after the NGPA's provisions had effectively cured earlier shortages, gas became more plentiful and prices became lower. Producers nevertheless continued seeking higher than market prices for gas covered by earlier executed take or pay contracts. As one consequence of higher prices, pipelines had difficulty selling gas.¹³ An oversupply resulted along with inevitable negative economic consequences flowing therefrom. Producers curtailed exploration and development of new reserves. Pipelines were burdened with substantial take or pay obligations. In sum, as a result of all of these circumstances brought on by the implementation of the NGPA, the natural gas markets became fraught with distortions.

In an initial attempt to correct these market distortions, the Commission issued a Notice of Inquiry wherein the Commission proposed to increase old gas prices. Notice of Inquiry, *Impact of the NGPA on Current and Projected Natural Gas Markets*, IV F.E.R.C. Stats. & Regs. ¶ 35,512 at 35,560, 47 Fed.Reg. 19,157 (1982). Specifically, the Commission's attempt in that regard was ultimately abandoned because of congressional opposition. See S. Res. 331, 97th Cong., 2d Sess. (1982). Some three years later on November 18, 1985, the Secretary of Energy (the "Secretary"), pursuant to Section 403 of the Department of Energy Organization Act,¹⁴ tendered to the Commission a notice of proposed rulemaking which, in turn, ultimately prompted the Commission's promulgation of Order No. 451. The Secretary, in his proposal, advanced the argument that the Commission's existing

¹³ Other factors also contributed to this circumstance. Among them were warmer temperatures and an economic recession.

¹⁴ 42 U.S.C. § 7173 *et seq.*

pricing scheme for old gas inhibited the production of vast reserves of old gas, encouraged the importation of oil and gas, and promoted higher prices to consumers. Significantly, the Secretary admitted that while legislative decontrol of gas prices would be the optimal solution for the problems caused by the old gas pricing structure, until such time as Congress did institute deregulation of old gas, the initiatives which eventually were embodied in Order No. 451 would provide an interim solution.

After notice and comment rulemaking and a two day public conference, the Commission issued Order No. 451 on June 6, 1986. The Commission, in Order No. 451, had adopted the Secretary's proposal with some modifications. In Order No. 451, the Commission collapsed the vintaging system which had prevailed under the NGPA and applied a replacement cost methodology to set an above market, purportedly "just and reasonable" price ceiling applicable to all categories of old gas. Thus, the Commission had essentially achieved de facto deregulation of old gas.¹⁵ First sellers of section 104 and section 106(a) gas were now able to charge up to the maximum lawful price, if the price were allowable under a contract entered into after July 18, 1986. Additionally, the Commission determined in Order No. 451 that the contractual authority for the increased sales prices of section 104 and section 106(a) gas was to be found in indefinite price escalator clauses present in existing contracts. The Commission, while acknowledging that the new price ceiling exceeded

¹⁵ The Commission's new price ceiling greatly exceeded the competitive market price that existed in June 1986, and continues to exceed the competitive market price today. Thus, de facto deregulation of old gas appears to have been the Commission's real goal, and that circumstance is best illustrated by the Commission's decision to base the "old gas" ceiling price on a replacement cost methodology that "[b]est reflect[ed] the level at which prices would be established if deregulation of old gas were to occur." Order No. 451 at 95 (emphasis supplied). Moreover, the Commission concedes that it has never before applied a replacement cost methodology to flowing (old) gas.

existing market prices, contended that market forces would reduce the actual price paid for old gas to levels consistent with the NGA's consumer protection mandate. Further, the Commission concluded that sections 104(b)(2) and 106(c) of the NGPA gave the Commission sweeping authority to raise old gas prices, and that there was no requirement that the Commission find the present gas prices unreasonable before raising them.¹⁶ Nevertheless, in Order No. 451, the Commission specifically found that the existing pricing scheme with respect to old gas was, in fact, unjust and unreasonable because it contributed to serious market distortions and thwarted gas reserve replacement.¹⁷

¹⁶ Sections 104(b)(2) and 106(c) of the NGPA are virtually identical and provide that

The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission) otherwise subject to the preceding provisions of this section, if such price is—

(A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(B) just and reasonable within the meaning of the Natural Gas Act.

15 U.S.C. §§ 3314(b)(2); see also 3316(c) (1982).

The above mention of the Natural Gas Act's "just and reasonable" language refers to the following provisions contained in section 4(a) of that Act:

All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

15 U.S.C. § 717c(a) (1982).

¹⁷ The Commission was driven, in part, by the explicit expectation that the provisions of Order No. 451 would stimulate increased production. In that regard,

In Order No. 451, and its successor, Order No. 451-A,¹⁸ the Commission prohibited the automatic collection of the new higher ceiling price for old gas explicitly acknowledging that the new ceiling would yield unjust and unreasonable prices. Order No. 451-A at 128. To prevent such a result, the Commission provided for a good faith negotiation (GFN) procedure governing price increases.

The GFN process, which can only be initiated by a producer, consists of three steps. Step One allows a producer

[T]he Commission found most persuasive studies showing that if current old gas prices were held at their present levels, approximately 11 Tcf of old gas reserves would not be produced. The 11 Tcf of old gas reserves not produced as a result of vintaging would have been replaced by higher-priced energy supplies. In part, these incremental supply requirements would be met by foreign imports of both oil and gas and the nation's energy security would thereby be compromised and its trade balance weakened. Regardless of the source of the incremental supplies, however, the nation's energy users would be required to pay more for these incremental supplies than would be necessary.

Order No. 451-A at 18. Other benefits were also expected by the Commission as a result of Order No. 451:

Producers with old gas reserves will obtain additional revenue for exploration and development of gas reserves. Customers will benefit from increased competition and may pay lower gas prices, free from regional disparities, as they gain access to alternative sources of supply and transportation through Order Nos. 451 and 436. The competitive pressures of a wide-open market may also benefit pipelines with increased throughput and the settlement of take-or-pay disputes with producers in exchange for the pipelines' agreement to pay higher old gas prices. Producers may also be persuaded to renegotiate high-cost gas contracts as old gas prices rise, in order to take advantage of increased marketing opportunities for their gas.

Shoneman & McConnell, *FERC Order No. 451: Freedom (Almost) for Old Gas*, 7 Energy L.J. 299, 324 (1986).

¹⁸ Order No. 451-A clarified Order No. 451. For a discussion of those clarifications, see Mogel and Mann, *Natural Gas: Current Federal and State Developments* 16-20 (1987).

to request a pipeline to nominate the price at which the pipeline would be willing to continue buying old gas under any existing contract.¹⁹ Step Two requires the pipeline to nominate the maximum price up to the ceiling price it would be willing to pay for the old gas *if it wishes to maintain the contract*. During Step Two, the pipeline also has the prerogative to request the producer to nominate a price at which the producer would be willing to continue sales of *any* gas (old or new) under *any other* existing multi-vintage contracts. Finally in Step Three, the producer has the prerogative to nominate a price for gas covered by the pipeline's Step Two request. During Step Three, the producer then may also request that the pipeline nominate a price for any old gas included in the multi-vintage contracts designated by the pipeline in Step Two.

As seen above, the producer (in Step One) is vested with the unilateral right to initiate the GFN process.²⁰ In the event that the pipeline (in Step Two) nominates anything less than the new, above market ceiling price for old gas as provided for in Order No. 451, the producer has an additional alternative: the producer has the unilateral right to terminate the existing sales contract,

¹⁹ Order No. 451 defines an existing contract to include an expired contract by which gas is being sold pursuant to an obligation imposed by a certificate of public convenience and necessity. The GFN procedure does not apply to contracts entered into after July 18, 1986, nor does it apply if, after that date, the parties renegotiate the sale price or any other sale terms of old gas under an existing contract. The Commission, on rehearing, did, however, allow for parties to agree in writing to preserve their rights under the GFN procedure even though an existing contract for old gas was amended after July 18, 1986.

²⁰ Although Order No. 451 became effective on July 18, 1986, a producer could not request pipeline nominations until November 1, 1986. Subsequently, that date was moved to December 18, 1986. Finally, as a result of the issuance of Order No. 451-A on December 15, 1986, the date was again postponed until 30 days after Order No. 451-A was published in the Federal Register.

receive automatic abandonment of the underlying sales obligation, and require the contracting non-open access pipeline to transport the released gas to new purchasers. To exercise its unilateral right to terminate the contract accordingly, the producer must provide the former pipeline purchaser with thirty days notice of contract termination, and must comply with certain requirements governing the subsequent sale of the released gas. In Step Three, if the producer does not nominate a price covered by the pipeline's Step Two request, the pipeline may terminate its purchases of all or part of the gas named in the request.

The joint opponents, petitioners herein, challenged the provisions of Order No. 451 through rulemaking comments and rehearing requests. The petitioners contended that the Commission did not have authority to adopt the Secretary's proposal because it 1) effectively deregulated old gas and eliminated vintaging contrary to congressional intent; and 2) used replacement costs as the starting point for the calculation of the new price ceilings on the old gas. The petitioners additionally asserted that current market conditions, specifically the surplus of natural gas, did not justify the need for such severe measures. Additionally, the petitioners objected to the Commission's failure to effectively address the problem of high cost take or pay contracts in its promulgation of Order No. 451. The petitioners complained that unless the Commission made the problem "take or pay" contracts market responsive, a tremendous increase in the old gas price ceiling would exacerbate the already serious problem and would ultimately result in higher consumer prices. Finally, the petitioners assert that the Commission's desire to protect against premature abandonment of certain old gas production and stimulate additional production from certain flowing gas reserves could be

achieved through alternative measures and in a far less costly manner.²¹

The Commission rejected the contentions of the petitioners and, on December 15, 1986, the Commission, by a unanimous vote, issued Order No. 451-A denying petitions for rehearing of Order No. 451. Thereafter, petitioners filed for review by this Court of the Commission's Order Nos. 451 and 451-A.

II. DISCUSSION

The petitioners object to the pricing, abandonment, take or pay and transportation components of Order Nos. 451 and 451-A. We will address each objection in turn.

A. Pricing

Perhaps the most salient and controversial provision of Order No. 451 is the Commission's new pricing structure for old gas. In establishing this new pricing structure, which, as mentioned previously, collapses the previous vintage system and sets a single higher than market ceiling price on old gas, the Commission relies on the "just and reasonable" standard articulated in sections 104(b)(2) and 106(c) of the NGPA. The petitioners strenuously argue that the Commission's reliance on sections 104(b)(2) and 106(c) as justification for raising ceiling prices on old gas is misplaced, and assert that the Commission has ignored congressional intent and exceeded its authority by allowing for de facto regulation of old gas. We are constrained to agree.

An examination of the legislative history of the NGPA reveals that its passage was the result of some nineteen months of heated Capitol Hill debates on the issue of whether the natural gas industry should be de-

²¹ For example, the petitioners contend that the Commission could have targeted specific old gas reserves rather than raising old gas price ceilings across the board.

regulated.²² As discussed above, the NGPA was Congress' response to natural gas shortages precipitated by

²² The following are excerpts from the Congressional record which demonstrate the challenges faced by Congress in resolving the differences of its members concerning decontrol of the natural gas industry and the complex problems involved in resolving the deficiencies of the NGA's regulatory devices.

124 Cong.Rec. S15019-20 (daily ed. Sept. 13, 1978) (remarks of Senator McIntyre).

Mr. President, it is time to resolve the conflict over natural gas pricing policy. . . . During the debate nearly a year ago, I was against the proposal to decontrol the price of natural gas. Instead, I favored a policy that would have provided incentives to the natural gas industry to bring in more gas, yet at the same time protect consumers from unwarranted increases and the inflationary effects of sudden price increases.

* * *

Clearly, we need a compromise between these two extremes. Clearly, we must establish a Federal policy that protects consumers and at the same time provides assurances and incentives to gas producers. Congress as a whole and the energy conferees have labored for nearly 17 long months to come up with a bill that provides this policy. They have put their collective wisdom into the compromise bill that is now before us.

* * *

It is apparent to all of us that the compromise is not perfect. Some of its flaws are obvious. For example, both the Senate and House passed so-called incremental pricing provisions to protect residential consumers of gas from being hit with the biggest increases. Somehow, the compromise ended up with an incremental pricing provision that protects residential consumers less than either the Senate or House bill.

* * *

And if we defeat this compromise, what policy will we put in its place for the long run? Are we to cave in to full decontrol, which would create about as much new supply as this bill, but at substantially higher cost? That is what the gas lobby is hoping for. That is why they are prowling the halls of Congress. And the other opponents of this compromise—the consumers organizations, whom I count as my friends—they want to defeat the compromise in the hope that the Federal bureaucracy will roll back gas prices and will on its own begin regulating the gas that producers are now keeping in their own states.

[Continued]

the Commission's lack of regulatory authority over the intrastate market. The NGPA, as recognized by the Supreme Court in *Public Serv. Comm'n of the State of New*

²² [Continued]

But this is Congress' job. The time has come for this body to put aside regional differences and partisan bickering. Both sides of the debate in the Congress have fought hard for what each thought was best. We now have before us a gas bill that gives neither side all that it wants. But this compromise does provide certainty; it does provide a unified Federal policy for the first time. It does provide substantial incentives for the production of more domestic natural gas. And at the same time it provides a measure of protection for consumers from sudden and unwarranted price increases.

124 Cong. Rec. S14869 (daily ed. Sept. 11, 1978) (remarks of Senator Jackson).

We are proposing a policy which concentrates the rewards of higher prices where they are most needed—on the development of new, high cost gas.

* * *

We wanted to elicit the maximum supply response at a minimum cost to consumers [i]t also allowed the conferees to achieve a bill that will encourage production while protecting consumers from applying unnecessarily high prices for gas that they could expect to receive at lower prices under current policies.

124 Cong. Rec. H13242 (daily ed. Oct. 14, 1978) (remarks of Rep. Sharp).

What we are proposing to do and asking Members to act upon is not a perfect solution.

* * *

Mr. Speaker, we put the highest incentive where the highest risks are and where the greatest gains might come from. The next highest incentives are where there are new gas supplies and major risks, but we think there are pretty good chances that gas can be found.

We tried to see to it that we were protecting the consumers from paying the highest prices where it was not deserved. We tried to focus those prices incentives where they would do the most good.

For additional discussion of the legislative history behind the NGPA, see Note, Legislative History of the Natural Gas Policy Act, 59 Texas L.Rev. 101 (1980).

York v. Mid-Louisiana Gas Co., 463 U.S. at 331, 103 S.Ct. at 3031, was the result of congressional compromise of two "strong, but divergent" positions with regard to the optimal strategy for stimulating increased production of natural gas without higher consumer prices. As we have previously recognized, the essence of the NGPA compromise was the adoption of "an incentive-based approach to rate-setting for gas production, providing substantially higher prices for 'new' gas than was currently available [while ensuring] consumer protection [through] lower prices on flowing gas, providing only limited future price deregulation in 1985, and extending price controls to intrastate sales of gas." *Pennzoil v. FERC*, 645 F.2d 360, 367 (5th Cir.1981) (footnotes omitted).

In that regard, we are persuaded that Congress deliberately chose to maintain lower old gas prices in order to "[concentrate] the rewards of higher prices where they are most needed—on the development of new, high cost gas" and to elicit "[t]he maximum supply response at a minimum cost to consumers." 124 Cong. Rec. S.14869 (daily ed. Sept. 11, 1978) (Remarks of Sen. Jackson). Further, remarks made by legislators during the NGPA debates support the conclusion that Congress did not intend for the Commission to abrogate, as Order No. 451 has done, the NGPA prescribed pricing structure. See, e.g., 124 Cong. Rec. 28,884 (1978) (Remarks of Sen. Hart: "[C]onsumers should be protected by regulations which prevent the price of old, inexpensive gas from rising"); 124 Cong. Rec. 28,865 (1978) (Remarks of Sen. Domenici: Elimination of vintaging and deregulation of old gas "not doable" or "ever suggested").

While we do not suggest that the Commission's contentions that the disorder in the natural gas market has resulted, at least in part, from the NGPA's vintage pricing structure which compelled natural gas producers to sell gas at below replacement costs are misguided, we nevertheless are constrained to recognize what we per-

ceive to be a clear congressional intent to preserve the old gas pricing provisions of the NGPA. The Commission contends that in promulgating Order No. 451, it has preserved the intent of Congress to protect consumers from higher prices. The Commission argues that, even though it has raised the price ceiling for old gas greatly in excess of current competitive market levels, market forces will nevertheless eventually act to hold old gas prices down. Further, the Commission reasoned that Order No. 451 would cause more old gas to be brought into the market place and that the increased volume of old gas in the market would bring pressure upon the existing sales of high priced new gas and that, as a competitive matter, new gas prices (or quantity of sales) would be reduced. Consequently, according to the Commission, these circumstances would more than offset the increased prices charged for old gas under Order No. 451's new high ceiling.

The Commission, in glossing over the mandates of the old gas pricing provisions of the NGPA, has attempted to rely on a somewhat ingenious application of the plain meaning rule²³ of statutory construction to implement its own scheme through an expansive reading of its authority under NGPA sections 104(b)(2) and 106(c). On rehearing, the Commission's own words betray its logic:

[T]he Commission recognizes that section 104(b)(1) of the NGPA was intended to directly incorporate the just and reasonable rates, and thus the cost-based prices according to vintage, in effect at the time of the NGPA's enactment. Further, the Commission agrees that Congress considered this provision for old gas prices to be a significant feature of the NGPA's design, intended to mitigate the effects on consumers

²³ See, e.g., *FERC v. Martin Exploration Management Co.*, 486 U.S. 204, 108 S.Ct. 1765, 1768, 100 L.Ed.2d 238 (1988) ("The plain meaning of the statute decides the issue presented.") (citation omitted).

of allowing higher prices for new gas. . . . However, . . . the Commission [has not] found any legislative history whatsoever on section 104(b)(2), or the virtually identical section 106(c) and 109(b)(2), that raises any doubt about its plain meaning. If Congress had intended old gas prices to be forever subject to the ceilings in effect when the NGPA was enacted, . . . sections 104(b)(2) and 106(c) would not have been included in the NGPA.

Order No. 451-A at 11-12 (footnote omitted). As we view the above language, Congress' intent was, as it has been in the past, to protect the interests of the consumer through the incorporation of a vintaged old gas pricing scheme "*as a significant feature of the NGPA's design.*" *Id.* (emphasis supplied).

We agree with the Commission that Congress did not intend, through enactment of the NGPA, to "render the Commission impotent in effectuating its statutory responsibility to serve the public interest." Respondent's Brief at 33. We are also compelled to observe, however, that Congress likewise did not intend, through enactment of the NGPA, to render the Commission omnipotent. Although sections 104(b)(2) and 106(c) do vest the Commission with the authority to raise the NGPA's ceiling prices in accordance with the "just and reasonable" standards of the NGA, this authority does not translate into unfettered discretion.²⁴ For the Commission to jetti-

²⁴ The Commission, in construing §§ 104(b)(2) and 106(c) to authorize the implementation of a new, higher than market ceiling price for old gas and the elimination of the old gas vintaging system, breaks virgin ground. The Commission has previously construed §§ 104(b)(2) and 106(c) far differently and much more narrowly than it does now. Its prior interpretation of §§ 104(b)(2) and 106(c) was to the effect that those provisions are more appropriately interpreted as special relief measures to be utilized in the event that existing congressional ceiling prices become confiscatory. See, e.g., Order No. 72, "Final Regulations Implementing

son a "significant feature of the NGPA's design" by abrogating the vintage pricing structure, represents, in our view, an improper exercise by the Commission of its limited authority to raise ceiling prices under NGPA sections 104(b)(2) and 106(c). As such, it is an untenable, albeit arguably meritorious,²⁵ solution to the problem of market distortion in the natural gas industry. More simply put, the Commission has exceeded the scope of its authority under the NGPA.²⁶

Section 109 of the Natural Gas Policy Act of 1978," F.E.R.C. Stats. & Reg. (CCH) ¶ 30,135 at 30,965 (1980). Moreover, this Court in *Pennzoil Co. v. FERC*, 645 F.2d 360 (5th Cir. 1981), emphasized that FERC has a "narrow[] authority to administer the NGPA and to prescribe higher price ceilings only in certain circumstances." *Id.* at 379 (emphasis omitted) (citations omitted).

We also note that if this Court were to uphold the Commission's new ceiling price on old gas, the issue could never be revisited except by congressional action. The NGPA does not allow the Commission to lower natural gas ceiling prices.

²⁵ In *Mid-Louisiana Gas Co. v. FERC*, 664 F.2d 530 (5th Cir. 1981), vacated on other grounds, *Public Serv. Comm'n of the State of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319, 103 S.Ct. 3024, 77 L.E.2d 668 (1983), this Court remarked that "[t]he Commission's duty is to administer the law Congress passed in light of the purposes for which it was passed. It is not an agency's prerogative to alter a statutory scheme even if its alteration is as good or better than the congressional one." *Id.* at 535 (emphasis supplied). Moreover, the Senate, on Wednesday, June 14, 1989, voted 82-17 in favor of a bill that would lift natural gas price controls on January 1, 1993.

²⁶ In further support of its contentions, the Commission argues that its new ceiling price is not really an "across the board" increase because the Commission explicitly declined to allow for an automatic rate increase. The Commission points to the good faith negotiation process as a fundamental component of Order No. 541 in support of this argument. The GFN process is, however, itself a source of dispute. During oral argument and on brief, the petitioners urged that the GFN process is unacceptably unilateral in nature, and as such, is unreasonable. The petitioners contend that while ostensibly labeled a negotiating device, the GFN process is more of a mechanism by which a producer can unilaterally rewrite

B. Abandonment

When Congress enacted the NGPA, it retained, for most "committed or dedicated" natural gas, the abandonment requirements of Section 7(b) of the NGA.²⁷ Under the Commission's Order No. 451, a producer may, in the event of unsuccessful good faith negotiation, receive automatic abandonment by executing a new sales agreement with a new purchaser and by providing the former pipeline purchaser with at least thirty days notice of contract termination. Thus, the Commission essentially has authorized "pre-granted" abandonment. The controlling regulation, found at 18 C.F.R. § 157.301(b), is captioned "Pre-granted abandonment" and provides that "[a]ny first seller who sells natural gas under the blanket certificate authority of paragraph (a) of this section is authorized to abandon the sale upon termination of the contract under which the sale is made."

the terms of a sales contract within, of course, prescribed parameters. The petitioners point to the fact that prior to the Commission's issuance of Order No. 451, many parties asked the Commission to allow pipelines as well as producers to initiate the GFN process; the Commission, however, rejected this proposal. Other parties requested authority for greater rights of first refusal for pipeline customers under the GFN process, but the Commission likewise rejected those proposals. In fact, the petitioners contend that every single proposal tendered by the petitioners to make the GFN process a more balanced procedure was denied by the Commission.

²⁷ Section 7(b) of the NGA reads as follows:

(b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, *after due hearing*, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

15 U.S.C. § 717f(b) (emphasis supplied).

The petitioners argue that the automatic abandonment procedures promulgated by the Commission amount to a flagrant and unacceptable evasion by the Commission of its regulatory responsibilities under Section 7(b) of the NGA. Further, the petitioners argue that by allowing abandonment determinations to "turn on producer discretion" and by precluding pipeline challenge to producer abandonment and subsequent fact-specific Commission review, the Commission has exceeded its authority under the NGA. The petitioners contend that through the blanket abandonment provisions adopted in Order No. 451, the "Commission withdrew its regulatory presence and allowed abandonment [to turn on] virtually absolute unilateral producer discretion, as guided by economic self-interest." Petitioner's Brief at 41.²⁸ The Commission, on the other hand, cites *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C.Cir.1987), *cert. denied sub nom. Interstate Natural Gas Assoc. v. FERC*, — U.S. —, 108 S.Ct. 1468, 99 L.Ed.2d 698 (1988), for the proposition that there is "no procedural objection to the Commission's identification of circumstances, in an otherwise valid rulemaking, which automatically trigger its approval of abandonment. . . ." *Id.* at 1015 n. 17 (citations omitted).

The petitioners point to the "after due hearing" language of section 7(b) as support for their argument that the Commission is obligated by the plain language of the statute to conduct a case specific review regarding abandonment. The Commission on the other hand contends

²⁸ In the past, the Commission has stated that "Section 7(b) . . . prohibits abandonments through the unilateral decision of particular producers based upon the economic considerations affecting them." *Arkansas Louisiana Gas Co. v. Amarez Inc.*, Opinion No. 798, 58 F.P.C. 1617, 1635 (1977). Yet, it would appear that the pre-authorized abandonment provisions and the GFN procedures promulgated by the Commission which are at issue here, would, for all practical purposes, do just that. For the first time, the Commission has placed abandonment authority in the hands of private parties.

that pre-granted abandonment in the context of Order No. 451 serves the overall public interest by ensuring that old gas is kept flowing to a willing purchaser. Further, the Commission disputes the petitioners' "after due hearing" argument by citing *Kansas Power & Light Co. v. FERC*, 851 F.2d 1479 (D.C.Cir.1988), for the proposition that, even in abandonment cases, "it is well established that the Commission need not hold an evidentiary hearing when no issue of material fact is in dispute." *Id.* at 1483. The Commission argues that the abandonment provisions of Order No. 451 represent Commission policy that the propriety of abandonment is governed by a balancing of the needs of current gas consumers being served by the gas reserves with the benefits that would be conferred on the natural gas market as a whole if these reserves were released from dedication.²⁹

The pre-grant abandonment runs contrary to the instruction of the Supreme Court in *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529, 99 S.Ct. 2461, 61 L.Ed.2d (1979). In *McCombs*, the Supreme Court reversed a

²⁹ The Commission first equated the public interest with the interest of the "market as a whole" in an abandonment context in *Felmont Oil Corp. and Essex Offshore, Inc.*, Opinion No. 245, 33 F.E.R.C. (CCH) ¶ 61,333 (1985), *reh'g. denied*, Opinion No. 245-A, 34 F.E.R.C. (CCH) ¶ 61,296 (1986), *rev'd and remanded on other ground sub nom. Consolidated Edison of New York v. FERC*, 823 F.2d 630 (D.C.Cir.1987). As the joint opponents point out, however, the *Felmont* case involved limited term abandonment after a case specific hearing. In *Felmont*, the Commission jettisoned the "comparative needs" test which calls for a comparison of the needs of the existing purchaser of the gas with the needs of the particular purchaser that would obtain the gas in the event of abandonment. In its place the Commission adopted a test which compares the needs of the existing purchaser with the needs of the "market as a whole." Nevertheless, the Commission emphasized that such a shift would not eliminate the need for a factual showing sufficient to justify the proposed abandonment, and that fact-specific consideration of the interests of existing beneficiaries of dedicated service, including mitigation of losses to such beneficiaries, would be preserved.

court of appeals' decision which held that, upon depletion of reserves, a producer may abandon sales without obtaining prior Commission approval. The Supreme Court concluded that such abandonment, without prior Commission approval, would, in effect, allow producers to determine when abandonment would be appropriate. This result, the Court reasoned, was inconsistent with congressional intent. The Commission distinguishes the *McCombs* case by noting that in the instant case, prior abandonment approval has, in fact, been granted by the Commission. We are not persuaded, however, that such a distinction is helpful to the Commission's argument. Rather, it appears that the pre-grant of abandonment contemplated by Order No. 451 would, as in the *McCombs* case, allow a producer, for all practical purposes, to control abandonment through the largely one sided GFN procedure.

In *Public Serv. Comm'n of the State of New York v. FPC*, 511 F.2d 338 (D.C.Cir.1975), the D.C. Circuit emphasized that "[t]here may be reason for the legislature to enact a deregulation for the natural gas industry, but so long as it prescribes a system of regulation by an agency subject to court review the courts may not abandon their responsibility by acquiescing in a charade or a rubber stamping of nonregulation in agency trappings." (citations omitted). *Id.* at 354. Accordingly, we are constrained to conclude that, in the instant case, the Commission has abdicated its responsibility under Section 7(b) of the NGA by providing for an across the board, pre-authorized abandonment provision. Surely such abandonment procedure, being altogether in the producer's control and which may be implemented only at the behest of producer, would be used only when such utilization would serve the producer's economic interest. As the Supreme Court noted in *United Gas Pipeline Corp. v. McCombs*, 442 U.S. 529, 99 S.Ct. 2461, 61 L.Ed.2d 54 (1979), the absence of provisions for factual inquiry into the circumstances for an abandonment allows for the "abandon-

ment determination [to] rest, as a practical matter, in the producer's control, a result clearly at odds with Congress' purpose to regulate the supply and price of natural gas." *Id.* at 539, 99 S.Ct. at 2467 (citations omitted).²⁰

C. Take or Pay

The take or pay problem was born during the 1970s when critical shortages of natural gas allowed producers to virtually dictate the terms and conditions of contracts for sale of natural gas to pipelines. During those years, the prevailing thought was that natural gas supply shortages would continue for quite some time and pipelines were frequently unable to procure enough gas to meet consumer demand. As a result, pipelines entered into take or pay contracts which typically required the pipeline to take a specified volume of gas from the producer or, in the event the gas was not taken, pay for the specified volume agreed to be taken but not taken. Additionally, take or pay contracts frequently contained automatic price escalation clauses which obligated the pipeline to pay either the highest price allowed by law or the highest price paid in a specific geographic area.

Pipelines today are faced with a market vastly different from the market in the 1970s. Conditions now are such that numerous pipelines simply are unable, in many circumstances, to take the quantity of gas required by existing take or pay contracts. Additionally, the natural

²⁰ We note that the Commission's reliance on *Felmont Oil Corp. and Essex Offshore, Inc.*, *supra*, is misplaced. *Felmont* involved limited term abandonments of shut-in gas. Moreover, *Felmont's* limited term abandonments were granted after a case specific evidentiary hearing. Nor are we persuaded by the Commission's assertions that the right to first refusal granted to a pipeline's firm sales customers protects consumer interests. As the petitioners point out, the Commission, in this assertion, fails to take into account that the right of first refusal has no effect on a pipeline's ability to continue to meet its systemwide obligations to provide adequate supplies of gas at reasonable prices.

gas market of today is characterized by oversupply, substantially lower rates for natural gas, and competition. Accordingly, pipelines with high liability take or pay contracts must pay prices for natural gas that are substantially in excess of current market prices. The end result is that both interstate and intrastate pipelines are currently burdened with take or pay contracts which potentially threaten their very existence as public utilities. At stake may be the spectre of unacceptable rate increases, of unpredictable price movements and even of the unavailability of gas supply.

The petitioners contend that the Commission effectively ignored take or pay issues in Order No. 451 notwithstanding its obligation to resolve the problem. In Order No. 451, the Commission stated that it "believes that the natural forces of competition will resolve the issues surrounding high cost contracts." Order No. 451 at 76. In further deference to forces outside its ambit of control, the Commission, in Order No. 451, reaffirmed its previous position that "problem contracts are primarily a matter for resolution between the parties involved." (footnote omitted).²¹ *Id.* Continuing, the Commission emphasized that "[f]or largely the same reasons expressed in Order Nos. 436 and affirmed in 436-A, the Commission . . . has confidence that the free operation of market forces will provide a resolution of this issue." *Id.* at 76-77 (footnotes omitted) (emphasis supplied).

In *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C.Cir.1987), the D.C. Circuit, vacating Order No. 436, rejected the Commission's adoption of the above rationale because it failed to effectively address the take or pay problem. The Court observed that the rationale

²¹ See Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol, Docket No. RM85-1-000, 50 Fed.Reg. 42,408, at 42,462-64 (Oct. 18, 1985); Order No. 436-A, 50 Fed.Reg. 52,217 (Dec. 23, 1985), vacated by *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C.Cir.1987).

"reflects questionable legal premises" and fails to meet the requirement of 'reasoned decisionmaking.'" *Id.* at 1023. We agree with the D.C. Circuit and conclude that the Commission's continued inaction on the take or pay problem is regrettable and unwarranted. As the D.C. Circuit remarked, the Commission's failure to take action on the take or pay problem "reflects a pervasive frame of mind of the Commission about a crucial problem in the natural gas industry." *Consolidated Edison*, 823 F.2d at 641-42. It simply cannot and "will not be wished away." *Id.* at 639.

The Commission also takes the position that the provisions of Order 451 will serve to facilitate the renegotiation of high cost contracts. In support of that contention, the Commission projects that under Order No. 451, pipelines will be able to offer higher old gas prices in return for reductions in new gas prices, and that contract reformations will thus ensue.³² We are persuaded, however, by the petitioners' contention that the "producers with the new gas problem contracts and the producers with the old gas contracts differ markedly." Petitioners' Brief at 63 (footnote omitted). More directly, the producers with the least amount of old gas have the largest amount of nonmarket responsive contracts. Additionally, even if a contract provides for the sales of old and new gas, the pipeline would probably not get much benefit at the bargaining table since only one-third of all new gas is contained in the multi-vintage contracts that the pipeline can bring to the table.

Most damaging to the Commission's position, however, is the previously discussed one-sided nature of the GFN process. Surely producers would not initiate the GFN process if by doing so, they ran the risk of giving up more on new gas contracts than they would receive in return for their old gas. As we view the operation of

³² Order No. 451 at 148.

Order No. 451, it would not, as the Commission asserts, alleviate the take or pay problem. Rather, the prospect for exacerbating the take or pay problem runs rampant throughout the provisions of Order No. 451. Accordingly, we conclude that the Commission's inaction on the take or pay problem is based on a rationale which is arbitrary and unsupportable.³³

D. Transportation

We turn now to the last component of Order No. 451 which is challenged by the petitioners—the mandatory transportation of released gas. As mentioned previously, Order No. 451 provides that an existing pipeline purchaser, that is not an open access pipeline,³⁴ must continue to transport any released gas if 1) the pipeline fails to nominate a price in response to the producer's initial request for such nomination, 2) nominates a price less than the highest price as provided for in the escalation provisions of the sales contract, 3) ceases to purchase gas when the first seller fails to submit a timely price nomination, or 4) ceases to purchase gas after rejecting the price nominated by the first seller. As observed by some commentators, this mandatory transportation provision of Order No. 451 appears, at first glance, to impose a common carrier obligation on pipelines in contravention of the Commission's authority under the NGA. See e.g., Mogel, *Transportation and Marketing of Natural Gas* 175 et seq. (1985); see also Mogel & Gregg, *Appropriateness of Imposing Common Carrier Status on*

³³ The joint opponents recommended a bilaterally initiated GFN process, expansion of renegotiation rights for problem contracts, and a provision for producer refund of take or pay payments which could no longer be "made up" because of Order No. 451.

³⁴ On the date this case was orally argued some 19 out of 21 major pipelines were either open access, or had filed for open access status.

Interstate Natural Gas Pipelines, 4 Energy L.J. 155 (1983).

The petitioners likewise adopt the position that the mandatory transportation requirements of Order No. 451 amount to nothing more than the imposition of common carrier obligations on natural gas pipelines, and that such obligations are not permitted under the NGA. In support of this position, the petitioners rely heavily on *Florida Power & Light v. FERC*, 660 F.2d 668 (5th Cir. 1981), *cert. denied*, 459 U.S. 1156, 103 S.Ct. 800, 74 L.Ed.2d 1003 (1982). In *Florida Power & Light*, the Commission ordered Florida Power and Light Company to file a tariff provision which required the Company to provide transportation to a point beyond that which it had agreed on. While *Florida Power & Light* arose under Section 205 and 206 of the Federal Power Act, its holding is nevertheless apposite to the facts in the instant case since NGA sections 4 and 5 were patterned after the Federal Power Act and are virtually identical to Sections 205 and 206 of the Federal Power Act. See *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332, 346, 76 S.Ct. 373, 381, 100 L.Ed. 373 (1956); *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 353, 76 S.Ct. 368, 371, 100 L.Ed. 388 (1956). In reversing the Commission's imposition of common carrier status in *Florida Power & Light*, this Court found that

[t]he imposition of common carrier status on FP & L, which the orders at issue accomplish, is precisely the authority which the [Federal Power Act] denies the Commission. The legislative history of the [Federal Power Act] makes clear that the Commission lacks the authority to require electric utilities to provide wheeling even on a reasonable request. Accordingly, we conclude that the Commission lacked statutory authority to issue the orders in question.

Florida Power & Light, 660 F.2d at 676 (footnote omitted).

The legislative history of the NGA, when viewed along side its predecessor, the Federal Power Act, leaves little room for doubt that the Commission has exceeded its authority in implementing the transportation requirements of Order No. 451. As the petitioners note, in the first legislation ever undertaken which affected natural gas pipelines, the Interstate Commerce Act of 1906, Congress expressly exempted transporters of natural gas from the definition of common carrier.³⁵ Later, in 1914, the House rejected a bill which would have imposed common carrier status on the pipelines.³⁶ Again, in 1935, Congress rejected a bill which would have required pipelines, among others, to transport gas for any person upon reasonable request.³⁷ As recently as 1978, Congress, in passing the NGPA, specifically precluded the Commission from treating pipelines as common carriers.³⁸ Even the Commission itself has recognized that the NGA fails to give it the authority to impose common carrier status on pipelines. See Order No. 490, "Abandonment of Sales and Purchases of Natural Gas Under Expired, Terminated, or Modified Contracts," III F.E.R.C. Stats. & Regs., Regulations Preambles, (CCH) ¶ 30,797 at 31,036 (1988). ("Pipelines are not common carriers and only have the duty imposed on them by their certificate.") Nevertheless, the Commission here has inexplicably exceeded its authority and essentially made non-open-access pipelines common carriers.

Moreover, the Commission ignored the requirements of the Administrative Procedure Act³⁹ in promulgating Order No. 451's mandatory transportation requirement.

³⁵ Pub.L. No. 59-337, 34 Stat. 584.

³⁶ S. 3345, 63rd Cong., 2d Sess., 50 Cong.Rec. 5847-49 (1913).

³⁷ H.R. 5423, 74th Cong., 1st Sess. 303, 304 (1935). See also Hearings Before the Committee on Interstate and Foreign Commerce, House of Representatives on H.R. 5423, 74th Cong. 1st Sess. 1646 (1935).

³⁸ See NGPA Section 602(b), 15 U.S.C. § 3432(b).

³⁹ 5 U.S.C. § 551 *et seq.*

The Commission's notice failed to request comment on its proposed authority, or lack thereof, to impose common carrier status on pipelines. Because the Commission's failure to do so precluded the presentation of relevant evidence essential to reasoned decisionmaking in this case, we must conclude that the Commission has avoided a fundamental responsibility under the Administrative Procedure Act. *See, e.g., Texaco, Inc. v. FPC*, 412 F.2d 740 (3d Cir. 1969). Accordingly, we are constrained to conclude that the Commission has exceeded its authority by imposing common carrier status on non-open-access pipelines through the mandatory transportation requirements of Order No. 451.

II. CONCLUSION

Having relied on the language, purposes and history of natural gas regulation as evidenced by the provisions of the NGA and the NGPA, we are constrained to conclude that the Commission has, in the promulgation of Order Nos. 451 and 451-A, exceeded its authority as conferred by Congress. Further, while we remain poignantly aware that the problems facing the natural gas industry are numerous and complex, we nevertheless emphasize that Congress alone has the power to do—or authorize the Commission to do—what the Commission has done in Order Nos. 451 and 451A. We must therefore vacate Order Nos. 451 and 451-A in their entirety; it is so ordered.

VACATED.

JOHN R. BROWN, Circuit Judge, dissenting.

Because the Court:

¶ *Looks* upon the question of (i) pricing (ii) good faith negotiation (iii) first refusal, (iv) abandonment and (v) mandatory transportation for new customers as separate, individual issues rather than

as integrated parts of a comprehensive solution to the problems of the natural gas business

¶ *Fails* to accord to the Federal Energy Regulatory Commission (FERC) the expertise which Congress invests in it for broad ranging operational fact conclusions and policy including replacement costs in lieu of historical costs of service

¶ *Undertakes* to decide on its own, the factual validity (invalidity) of long range predictions of the Commission

¶ *Overlooks* specific congressional language giving express legislative authority to raise the price of old gas

¶ *Presumes* to impose on the Commission responsibilities to consider and, once and for all, to solve the vexing problem of Take-or-Pay

¶ *Disregards* the practical necessities in the Commission's determination to permit abandonment of existing contracts after good faith negotiation

¶ *Disregards*, likewise, the practical necessities of requiring mandatory transportation by "open access" pipelines of gas for new customers after good faith negotiations and right of first refusal to existing customers and in effect

¶ *Substitutes* its own judgment for that of the Commission on what Congress has ordained the Commission may do about the grave problems of the natural gas business,

I must respectfully dissent.

A Big Single Package

Following the highest political traditions of this nation, in which the people expect of the President and the Executive Department the initiation of programs and

policies affecting matters of great public importance, the action of FERC in the 451 Orders owes much to the Secretary of Energy's December 1985 statement:

The existing price structure for old gas creates a barrier against the *production of tens of trillions of cubic feet of old gas reserves*, even though these reserves are easier and less expensive to produce than other gas sources. The artificially low prices imposed on old gas by the existing price structure prevents us from producing all our economically recoverable old gas supplies. As a result, Americans are consuming gas from more expensive sources, as well as imported oil and gas, instead of *first consuming inexpensive old gas*. America should produce all its economical gas resources, but it should produce its least expensive gas first. The Department estimates that greater recovery of domestic old gas resources would provide the U.S. economy with *economic benefits of over \$25 billion during the next decade*. The benefits would result from greater economic efficiency, higher domestic gas production and lower payments for gas and oil imports. (Emphasis added).

This precipitated FERC's initiation of extended proceedings on the problems of the natural gas business including gas surplus and reduced demand, but increasing city/gate prices. The Commission held extended hearings and received written comments from all segments of the gas industry. Thereafter, the Commission, exercising its authority under NGPA §§ 104 and 106¹ to

¹ Section 104(b)(2):

Ceiling prices may be increased if just and reasonable. The Commission may, by rule or order, prescribe a maximum lawful ceiling price, applicable to any first sale of any natural gas (or category thereof, as determined by the Commission)

raise ceiling prices "if just and reasonable within the meaning of the Natural Gas Act," issued the two hundred seventy-four page Order No. 451. (R. 5390-5664).

Sharply abbreviated, Order 451:

Allows producers (first sellers) of old gas to engage in Good Faith Negotiations (GFN) with pipeline purchasers for a higher price up to the newly created ceilings;

allows sellers to terminate existing contracts in the absence of agreement from GFN;

allows existing sellers to terminate and abandon existing contracts where agreement is reached with a new user/purchaser after notice of first refusal.

The result was to collapse the fifteen different "vintage" price categories under NGPA § 104(a) into a single category with the ceiling price pegged to the highest of the vintage rates. Three reasons were expressed. First, valuable supplies of inexpensive old gas were being inadequately developed. The Commission found that raising the ceiling price would have a significant impact allowing "over 11 Tcf [trillion cubic feet] of additional old gas to be recovered." (R. 5414). Second, the Commission determined that vintage prices kept this old gas priced below a competitive market price. The unequal access to low cost old gas resulted in certain consumers and regions obtaining an unfair competitive advantage.²

otherwise subject to the preceding provisions of this section, if such price is—

(A) higher than the maximum lawful price which would otherwise be applicable under such provisions; and

(B) just and reasonable within the meaning of the Natural Gas Act.

15 U.S.C. § 3314(b)(2) (1982); see also 15 U.S.C. § 3316(c) (1982).

² The Commission found that:

wide variations in pipeline access to old gas have created huge disparities in the prices consumers pay for gas at the burner-

Third, in addition to the competitive advantage to some pipelines the rolling-in old gas prices subsidized producers' sales of high-cost gas or price-deregulated gas.

After first determining that since §§ 104(b)(2) and 106(c) expressly authorized the revision of old gas ceiling prices the Commission need not find existing old gas prices unjust and unreasonable in order to change them, the Commission proceeded to find that the existing old gas price structure was unjust and unreasonable because of these distortions and the reserve replacement it engendered. (See R. 5460). The Commission then reached this profound conclusion:

[T]he current problems being experienced in natural gas markets would largely be remedied by collapsing vintages and raising ceiling prices of below-market priced gas.

(R. 5461).

The Replacement Cost Approach

Pursuing its finding that a price increase for "old gas" was necessary, the Commission determined that any ceiling price should, as closely as possible, approximate the replacement cost of that gas.

After explaining that it had previously used replacement costs, see Opinion No. 699-H, 52 FPC 1604, 1631 *aff'd*, *Shell Oil Co. v. FPC*, 520 F.2d 1061, 1076-77 (5th Cir.1975), *cert. denied*, 426 U.S. 941, 96 S.Ct. 2661, 49

tip around the country. For example, in 1984, the average residential price of gas in Washington, D.C. was \$8.05 per Mcf, while the average price in Kansas was \$4.49 per Mcf. Kansas is served by KN Energy and Northern Natural, whose old gas "cushions" in 1984 amounted to 65 percent and 47 percent of their wellhead purchases, respectively. On the other hand, Washington, D.C. is served by Transcontinental Gas Pipe Line whose 1984 old gas cushion was only 28 percent of its total purchases.

R. 5414-15.

L.Ed.2d 394 (1976); and see Opinion No. 770, 56 FPC 509, 521, *aff'd*, *American Public Gas Ass'n. v. FPC*, 567 F.2d 1016, 1033 (D.C.Cir.1977), the Commission concluded:

It seems clear based on the above-cited judicial precedents that the issues of replacement costs versus historical costs as well as vintage-based versus uniform rates are matters within the Commission's reasonably exercised discretion.

* * *

The NGPA provides strong economic support for pricing old gas at the long-run marginal cost of gas, which is equivalent to replacement cost.

(R. 5485).

Good Faith Negotiations

For natural gas sold under existing contracts having an indefinite price escalator clause, the Commission created a good faith negotiation (GFN) procedure, 18 CFR § 270.201 (1988), under which the producer/seller, to obtain any rate increase, must first request a renegotiation (nomination) of the existing contract price. The purchaser (usually a pipeline) may then accept or reject those terms or proposed alternative prices. The existing purchaser is not obligated to purchase gas it cannot market. If the producer invokes GFN the pipeline/purchaser can require the producer to renegotiate any contracts covering the sale of both vintage (old) gas and high-cost (new or deregulated) gas. See 18 CFR § 270.201 (b)(2) (1988). The Commission, in a reasoned way,³

³ See Order No. 451, p. 185:

... the Commission agrees ... that the good faith negotiation rule ... could be unbalanced ... For example, if a contract included both old and other gas, the producer could seek a higher price for the old gas but the purchaser could not seek a lower price for other gas. If the producer was not satisfied with the price nominated by the purchaser for the old gas, the producer could terminate sales of the old gas to the purchaser,

found that this provision was necessary to balance the operation of GFN and to provide pipelines/purchasers with a means to reduce high-cost gas purchases. The upshot is that if the producer and pipeline/purchaser are unable to agree on new price terms, old gas and mixed contracts can be terminated by either party. On the other hand, if a new price is otherwise mutually agreed upon the sale must continue at the agreed upon price.

Abandonment and Transportation Provisions

As an essential ingredient of the GFN rule, the Commission added two additional provisions to ensure that the old gas continued to reach the market at a fair, negotiated price. First, if a pipeline purchaser fails to respond to the producer's new price nominations and rejects⁴ the producer's price to terminate the gas purchase agreement, "[t]he first seller (producer) is authorized, upon 30-days written notice to the existing purchaser, to abandon the sale of the gas" if it has contracted to sell the gas to a new purchaser. 18 CFR §§ 270.201(c)(1), (e)(4) and (f)(5) (1988). Such producer abandon-

sell that gas to a third party, but require the purchaser to continue purchasing the other gas. . . .

In order to cure these inequities in the operation of the good faith negotiation rule . . . the Commission will modify the [GFN] rule . . . [to] permit the purchaser to seek a lower price for any gas . . . in any contract between the parties which contains some old gas.

(R. 5580-81).

⁴ If the producer rejects the nominated price, the producer would be free to sell all the gas to a new purchaser subject to the right of first refusal on the part of the existing firm customers of the existing purchaser. There would be no required term for the new contract, nor any higher price requirement. Once a new purchaser is found, the producer would be released from all obligations in law and contract to the existing purchaser upon 30 days notice. However, in the interim, the producer would be required to continue to sell the gas to the existing purchaser at the existing contract price. R. 5592, Order No. 451.

ment occurs without further Commission action under § 7(b) of the NGA.⁵

The second provision requires that if there is an abandonment of the sale to the pipeline and a sale by the producer of the released gas to others, the pipeline, if not an "open access" pipeline, must continue to transport that gas. 18 CFR § 270.201(a) (1988).

The Commission found:

We conclude that this rule [GFN] should establish reasonable procedures by which gas is released . . . can be transported by pipelines not under Order No. 436. . . . However, without Commission action, there is no assurance that first sellers will be able to market their released gas unless their existing purchasers have accepted the terms and conditions of Order No. 436. We believe it is essential . . . to assure the availability of transportation service irrespective of whether a particular purchaser has or has not accepted the open-access obligations of Order No. 436 . . .

to formulate reasonable and fair transportation provisions. (R. 5608-09).

Without access to transportation, the GFN process would be insulated from competitive benefits and both producers and pipelines would be restricted in their access to gas supplies released under the rule.

Under the good faith negotiation procedure, the existing pipeline purchaser may choose or not choose to terminate purchases of gas under an existing contract with a producer. As a condition on the pipeline's exercise of these options, the limited transportation authority is reasonably intended to assure that

⁵ If the pipeline is not "open access" such pipeline's firm gas customers "would specifically have a 'right of first refusal'." See 18 CFR 270.201(g) (1988).

the pipeline's existing customers, especially firm sales customers, have a practical means of keeping the gas on-system and getting it transported for their use.

* * *

In most instances, first sellers would be unable to market released gas to alternative purchasers unless the existing purchaser agreed to transport the gas or is an Order No. 436 transporter. The existing purchaser would have little, if any, incentive to do so, however, because in the absence of transportation the first seller would have little alternative but to continue selling to the existing purchaser at the current price. The result would frustrate the purposes of this rule and force the first seller to accept a price which we have found to deny both consumers and producers the full benefits of competition and long-term reliable gas service under the NGPA and NGA. We therefore believe that [GFN] would be ineffective . . . unless combined with a transportation provision designed to encourage purchasers to negotiate in good faith and to provide first sellers with reasonable access to an alternative market in the event no agreement on pricing is reached.

(R. 5610, 5611-12).

However, newly priced gas must be keyed to the availability of transportation, or the market-responsive benefit of the rule would be lost, and the public interest benefits of the new ceiling prices also lost. It is in this sense that the new ceiling is only just and reasonable in conjunction with the accompanying transportation provision.

(R. 7428).

The Commission also found that while the price of gas might go up from increased old gas prices it would lower prices and increase supply in the long run.

On rehearing the Commission reaffirmed its finding that producer abandonment was in the overall public in-

terest, (R. 7315), and that over the long haul, customers would have better access to supplies of gas if the old gas could get a willing purchaser. The Commission also reaffirmed its ruling requiring pipelines to continue to provide transportation. (R. 7419).⁶

Pricing

The Court's opinion finds that FERC's abandonment of vintaging and establishing the new ceiling prices for old gas is contrary to both the NGA and the NGPA and beyond the statutory powers of the Commission. Cast in this light, the controversy becomes essentially a rate case "to assure an adequate and reliable supply of gas at reasonable prices." *California v. Southland Royalty Co.*, 436 U.S. 519, 523, 98 S.Ct. 1955, 1957, 56 L.Ed.2d 505 (1977), citing *Sunray Mid-Continent Oil Company v. FPC*, 364 U.S. 137, 147, 151-154, 80 S.Ct. 1392, 1398, 1400-1402, 4 L.Ed.2d 1623 (1960) and *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378, 388, 79 S.Ct. 1246, 1253, 3 L.Ed.2d 1312 (1959). Under the just and reasonable standard, § 5, 15 U.S.C. § 717d, the Commission's approval rate must:

[R]easonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed and yet provide appropriate protection to the relevant public interests, both existing and foreseeable.

Permian Basin Area Rate Cases, 390 U.S. 747, 792, 88 S.Ct. 1344, 1373, 20 L.Ed.2d 312 (1968).

⁶ In addition to stressing practical necessities and avoidance of frustration of the objectives of GFN, the Commission stated:

By requiring a pipeline to continue to provide transportation for released volumes, the pipeline is prevented from unduly discriminating against the existing seller and harming competition by denying a producer transportation and thereby blocking the benefits of the final rule.

R. 7428.

In setting "just and reasonable" rates the Commission is not "bound to the service of any single regulatory formula," *Permian*, 390 U.S. at 776, 777, 88 S.Ct. at 1364, 1365, and so long as the Commission engages in reasoned decision making under the just and reasonable standard ". . . it is the result reached not the method employed which is controlling." *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602, 64 S.Ct. 281, 287, 88 L.Ed. 333 (1944). All that is needed is a reasoned basis by the Commission "to assure itself that the Commission has given reasoned consideration" to the relevant factors. *Permian Basin Area Rate Cases*, 390 U.S. at 792, 88 S.Ct. at 1373.

After enactment of the NGPA "[t]he aim of federal regulation remains to assure adequate supplies of natural gas at fair prices." *Transcontinental Gas Pipeline Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. 409, 421, 106 S.Ct. 709, 716, 88 L.Ed.2d 732 (1986).

*NGPA Provides Express Authority to
Raise Old Gas Ceiling Prices*

By §§ 104 and 106 of the NGPA, Congress could not have been more explicit in authorizing the Commission to raise statutory ceiling prices for committed or dedicated gas sales "if such [higher] price is . . . just and reasonable within the meaning of the Natural Gas Act." §§ 104 (b) (2) (B) and 106(c), 15 U.S.C. §§ 3314(b) (2) (B) and 3316(c) (1982), *see note 1, supra*. This authority applies to any first sale of *any* natural gas subject to § 104(b) (2), 15 U.S.C. § 3314(b) (2) (1982). This means that Congress granted the Commission the express authority to raise the ceiling prices for vintage gas sales. As the Supreme Court described it, "the statute recognizes that the ceiling may be too low and authorizes the Commission to raise it whenever traditional NGA principles would indicate a higher price." *Public Service Comm'n of New York v. Mid-Louisiana Gas Co.*, 463 U.S.

319, 333, 103 S.Ct. 3024, 3032, 77 L.Ed.2d 668 (1983) (emphasis in original).

The sweeping nature of this legislative grant is reflected by expressly allowing this authority to be exercised "by rule or order." Exercise of this power is not confined to case-by-case rate making. It is entirely appropriate for it to be used and employed generically.⁷ Nor is there any basis for thinking that Congress intended or demanded that vintage pricing be continued in perpetuity. *Subcommittee on Energy and Power*, 95th Cong., 1st Sess., *Economic Analysis of Natural Gas Policy Alternatives* (Comm. Print 31, 1977) ("Both House and Senate versions would eliminate vintaging of new natural gas.").

Whatever the nuances of expressions by individual members of the Congress in the so-called legislative history, the words of Congress are explicit and decisive. They reflect in no uncertain terms that in enacting the NGA, Congress did not mean to adopt a self-defeating statutory scheme which would bar the Commission from raising vintage ceilings when to do so was part of a comprehensive effort "to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges." *Atlanta Refining Co. v. Public Services Commission of New York (CATCO)*, 360 U.S. 378, 388, 79 S.Ct. 1246, 1253, 3 L.Ed.2d 1312 (1959).

*Commission's Determinations Just and
Reasonable Under NGA*

The Commission meets its just and reasonable NGA responsibilities when it sets rates to assure that there is "an adequate and reliable supply of gas at reasonable

⁷ In a related context, *see Texas Eastern Transmission Corp. v. FERC*, 769 F.2d 1053, 1061 (5th Cir. 1985), *cert. denied*, 476 U.S. 1114, 106 S.Ct. 1967, 90 L.Ed.2d 652 (1986), "the drafters' choice of the words 'rule or order' . . . clearly contemplates the establishment of an industry-wide scheme of reimbursement."

prices," *California v. Southland Royalty Company*, 436 U.S. 519, 523, 98 S.Ct. 1955, 1957, 56 L.Ed.2d 505 (1978). The accepted precedents do not require that "just and reasonable" rate making invariably requires rates pegged to recover only historically-based costs.⁸ The choice whether to adopt replacement cost pricing "to put some of the burden of replacing scarce gas supplies on the consumers of flowing gas" is the Commission's to make, *Tenneco Oil Co. v. FERC*, 571 F.2d 834, 840 (5th Cir. 1978), *cert. dismissed*, 439 U.S. 801, 99 S.Ct. 43, 58 L.Ed.2d 94 (1978), and this Court has affirmed the Commission's choice to do so. *Shell Oil Co. v. FERC*, 520 F.2d 1061 (5th Cir.1975), *cert. denied*, 426 U.S. 941, 96 S.Ct. 2661, 49 L.Ed.2d 394 (1976).

Without implying, as the Court's opinion suggests, that sustaining Order No 451 would make the Commission *omnipotent* beyond the powers established by Congress, it is clear beyond question that Congress did not by the NGPA intend to render the Commission *impotent* in effectuating its statutory responsibility to serve the public interest. Rather, as the Supreme Court has clearly stated, to achieve the regulatory goal, the Commission must be free "to make the pragmatic adjustments which may be called for by particular circumstances." *Permian Basin*, 390 U.S. at 777, 88 S.Ct. at 1365, quoting *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037 (1942).

Replacement cost pricing does not in any way depart from the NGPA's regulatory scheme. The NGPA introduced a regime of market-based wellhead pricing. As the Commission explained in considerable detail, (R. 5433-5437, 5443-5449, 7207-7212, 7324-7333), providing for renegotiation of old gas sales prices capped by a replacement cost ceiling properly carries out the free market

⁸ Reliance on *City of Detroit v. FPC*, 230 F.2d 810 (D.C.Cir. 1955) and *Bell Oil Corp. v. FPC*, 255 F.2d 548, 553 (5th Cir.) are misplaced. (See R. 7233-37).

approach reflected in the congressional enactment of the NGPA.

*Overall Impact of Commission's Orders
Just and Reasonable*

The GFN is in no sense an "across-the-board rate increase." Rather, it affords the purchaser the option to pay or not to pay a higher price, to renegotiate some high-cost ("new") gas prices, and to have the opportunity to cancel gas purchase contracts thus paying no increased rates. GFN is a fundamental part of the 451 Orders assuring, in line with the NGPA pricing approach, that prices reflect the market's needs and that the rates are "just and reasonable."

There is no basis for the contention by protestants that increased lower gas prices will result. The Commission's extended explanation, (*see* R. 5529-5568 and 7283-7306), fully supports the Commission's judgmental conclusion that while prices to some consumers might rise in the short term under the new rules, overall and in the long term prices would be lower than otherwise because of the increased supply of relatively lower-priced old gas in the open market competing with the more expensive, incentive-priced and deregulated gas.⁹ This is the sort of

⁹ The Commission found that:

under [the] "good faith" negotiation rule, old gas would actually be priced at the prevailing market price or the new ceiling price, so the practical effect of the proposed rule is to provide a price for old gas equal to the market price or replacement cost, *whichever is lower*.

R. 5487.

And, as the Commission expressed on rehearing:

The Commission continues to believe that eliminating vintaging will cause a substantial increase in recoverable reserves of old gas. Furthermore, nothing raised on rehearing causes the Commission to modify its belief that DOE's study predicting an approximately 11 Tcf increase is the most convincing analysis in the record of that increase.

R. 7262.

expert prediction—"[t]hat 'the increased incentive to compete vigorously in the market would eventually lead to lower prices for all consumers'"—which should be given deference by the courts. *Associated Gas Distributors v. FERC*, 824 F.2d 981, 1008 (D.C.Cir. 1987) (citations omitted).

An essential ingredient in this analysis is that wellhead gas is now practically competitive. The Commission affirms:

The Commission believes, however, that the market for wellhead natural gas sales is workably competitive. In the first place, Congress so found when it enacted the NGPA. Implicit in the removal of the Commission's authority to regulate the price of new gas is a finding that the wellhead market for natural gas is competitive.

(See R. 5532).

As this Court stated in *Pennzoil v. FERC*, 645 F.2d 360, 378-79 (5th Cir. 1981):

Contrary to the Supreme Court's assumption in *Phillips Petroleum Company v. Wisconsin*, 347 U.S. 672 [74 S.Ct. 794, 98 L.Ed. 1035] (1954), which subjected gas producers to utility-type regulation under the NGA, Congress apparently decided that gas producers do not have "natural" monopoly power.

Similarly, in *Transcontinental Gas Pipeline Corp. v. State Oil and Gas Board of Mississippi*, 474 U.S. 409, 421, 106 S.Ct. 709, 716, 88 L.Ed.2d 732 (1986), the Supreme Court stated, "the NGPA reflects a congressional belief that a new system of natural gas pricing was needed to balance supply and demand . . . [t]he new federal role is to 'oversee a national market price regulatory scheme.'" (Emphasis added).

Nor is there any basis for the contention that the Commission "assumed" away the problem of uneconomical

contracts or the existence of a present gas market surplus. The Commission in a reasoned way reached the view that the 451 Orders, by increasing the competition for low-cost gas and by providing pipelines, through the GFN, with the power to require producers seeking higher old gas prices to renegotiate high-cost gas sales in mixed contracts, would blunt the force of uneconomic contracts.

*Producer Abandonment and Mandatory Transportation:
Proper Exercise of Statutory Authority*

This is really at the heart of the goals of Order No. 451. As the Commission explains, Order No. 451 would be a meaningless exercise if, despite the Commission's finding that the vintage pricing system was unjust and unreasonable, pipelines with dominant market power could nevertheless effectively nullify GFN and shut in the gas or otherwise prevent increased supplies from reaching the market at a competitive price.¹⁰

The GFN does not, as claimed, empower a producer unilaterally to abandon old gas sales. A producer may abandon only if: (1) the GFN process does not work and the pipeline signals its intent not to purchase the gas at a mutually agreed price; and (2) the producer has contracted to sell the gas to a new purchaser. 18 CFR §§ 270.201(c)(1); (e)(3) and (4); and (f)(5) (1988).

The rule, circumscribed as it is with protective conditions, reflects the Commission's determination that it is in

¹⁰ The Commission said:

As the Commission stated in Order No. 451, abandonment under the good faith negotiation rule is in the public interest, since it is necessary to ensure that the goals of Order No. 451 of increased production of old gas and overall lower prices described . . . are achieved. These goals cannot be achieved unless producers can obtain the market-responsive prices permitted by the rule. Without the possibility of abandonment, purchasers under existing contracts could prevent producers from obtaining those prices by insisting on continuation of the present price.

the overall public interest that the old gas continue to flow to a willing purchaser. (R. 7314-7320).

Nor, as this Court's opinion asserts, does § 7(b) of the NGA condemn this streamlined abandonment procedure so obviously demanded by practical necessities. The language of § 7(b) does not require that the Commission act on such matters only case-by-case. Nor does any such right arise by implication from the "due hearing" requirement of § 7(b). See *Kansas Power and Light Co. v. FERC*, 851 F.2d 1479 (D.C.Cir. 1988). And, as the D.C. Circuit declared in its monumental *Associated Gas Distributors v. FERC*, 824 F.2d 981, 1015, n. 17 (D.C. Cir. 1987), case, there is "no procedural objection to the Commission's identification of circumstances . . . which automatically trigger its approval of abandonment" since the law has long recognized that the Commission may act generically when the situation warrants. See, e.g., *Permian Basin Area Rate Cases*, 390 U.S. at 774-777, 88 S.Ct. at 1365.¹¹

The public interest is clearly served by these hedged-in conditions. First, the Commission found "generally a purchaser's loss of gas under abandonment provisions of the good faith negotiation rule should not cause it, or the market it serves, to experience a shortage of supply." (R. 7318). (Emphasis added). With open access pipeline transportation and mandated transportation by non-"open access" pipelines and the right of first refusal accorded the purchaser's firm customers over any released gas, customers are assured access to sufficient supplies at reasonable prices now and into the future. (R. 7318-19).¹² To this is added the significant requirement that

¹¹ Nor is the Commission's rejection of decisions under the Interstate Commerce Act (ICC) faulty.

¹² In addition, requiring individual producers to file abandonment applications and considering those applications on a case-by-case basis is an inadequate solution. That would cause

abandonment under GFN is permissible only when there is a particular new customer who has contracted to take the gas at a market responsive price which assures that the gas will get to the market.

Mandatory Transportation Lawful

Under the rules established in the 451 Orders, an interstate pipeline not subject to "open access" regulations that stops purchasing the producer's gas "must transport any gas released due to termination or abandonment" under the GFN procedures. 18 CFR § 270.201(h) (1988). To facilitate this change of service—from interstate transportation and sale to transportation only—the Commission provides a "blanket" certificate. This Court's opinion holds this to be unauthorized as imposing "common carrier" responsibilities on the unwilling or reluctant pipeline. Essentially these same arguments were presented and rejected by the D.C. Circuit in the attack on the Commission's "open access" rules in its celebrated *Associated Gas Distributors* case.¹³ After first discussing the pertinence of §§ 5, 7, and 16 of the NGA that Court continued, there is "no language in the NGA barring the Commission from imposing common carrier status on natural gas pipelines, and certainly none barring it from imposing on the pipelines a specific duty that happens to be a typical or even core component of such status." 824 F.2d at 997. That Court found no basis for the attacks

lengthy delays before abandonments could be granted, given the vast number of producers in the nation and the Commission's limited resources. Achievement of the goals of increased production and lower overall prices would thereby be substantially delayed. Thus, granting abandonment in the present proceeding, if the conditions set forth in the Good Faith Negotiation rule are met, is in the interest of the natural gas market as a whole and is necessary to bring about market-responsive prices for old gas and overall lower prices.

R. 7351-52.

¹³ 824 F.2d 981 (D.C.Cir. 1987).

on "open access" under either the provisions of the NGA or its legislative history, 824 F.2d at 997-1001, or under either the NGPA, 824 F.2d at 1001-1003, or the Fifth Circuit's decision in *Florida Power and Light v. FERC*, 660 F.2d 668 (5th Cir. 1981).¹⁴ See 824 F.2d at 998-99.

Quite apart from the arguments on common carrier status, the Court's opinion errs in disapproving the Commission's order.

First, there seems to be a major misconception. The Commission imposed no new "mandatory" transportation obligation at all. Rather, the Commission required only "a continuation of the pipeline's existing service obligation to move gas to market."¹⁵ Theretofore, the pipeline may have been a *merchant* purchasing gas at the well-head and a *transporter* carrying the gas to its customers. Now, once GFN procedures have failed to result in agreement upon a new price for old gas under existing contracts, the pipeline becomes a *transporter* moving essentially the *same* gas but now purchased by someone else. The critical fact is that the essential transportation service for the same gas to the interstate market remains exactly the same. (R. 7429-30).

Following traditional lines so stressed by the protestants and this Court's opinion, § 7 of the NGA imposes "a continuing regulatory obligation, irrespective of private contractual arrangements, not to abandon any certificated obligations before obtaining authorization from the Commission to do so." *Panhandle Eastern Pipe Line Co. v. FERC*, 803 F.2d 726, 728 (D.C.Cir. 1986), citing *United Gas Pipe Line Co. v. McCombs*, 442 U.S. 529, 99 S.Ct. 2461, 61 L.Ed.2d 54 (1979). In the light of this, what the Commission requires is nothing more than that the pipeline, choosing to terminate its gas merchant function

¹⁴ This decision if relevantly significant is, of course, binding on me.

¹⁵ R. 7429 (citation omitted).

under GFN, must nevertheless continue to provide its transport service.

Finally, as the Commission explains so vividly, (R. 7428-7430), there are practical necessities sustaining the administrative reasonableness of the Commission's action. Not to require the pipeline to continue its transportation service would seriously impair if not completely undercut, the availability of market-priced gas to the market. It would also offset the consequences of the GFN. Significantly, the only interstate pipelines subject to this mandatory transportation are those few non-"open access" pipelines. Whatever the rights of these very few¹⁶ non-"open access" pipelines—none involved here—their rights ought not to pull down the whole house of cards as to those already bound¹⁷ to transport under "open access" requirements.

Take or Pay Solution not Mandatorily Required

Probably the most startling part of the Court's opinion is its presuming to direct the Commission to consider, and once and for all to *solve*, a matter so perplexing and complex as the issue of take-or-pay contracts.

Granted that it is a serious problem and one which needs a solution if—and the if may be a very big one—it can be solved independently of the ultimate insolvency of major pipeline takers and payers.

¹⁶ All but two of the twenty-one major pipelines are consensually "open access." See n. 34, Court's opinion.

¹⁷ Ironically, indicating perhaps the simple reflex of opposition by so many to any and every new effort to unscramble natural gas [problems], is the fact that joining the Joint Opponents' briefs are a number of party-pipelines who have accepted "open access." See, e.g., *Transcontinental Gas Pipe Line Corp.*, 43 FERC ¶ 61,196 (1988); *Tennessee Gas Pipeline Co.*, 39 FERC ¶ 61,337 (1987); *Natural Gas Pipeline Co. of America*, 39 FERC ¶ 61,153 (1987); *Williams Natural Gas Co.*, 43 FERC ¶ 62,171 (1988); and *ANR Pipeline Co.*, 44 FERC ¶ 61,126 (1988).

As this very Court has recognized in rejecting similar arguments, the take-or-pay issue is a discreet matter, "which is being addressed in other proceedings before the Commission and through other means." *Transwestern Pipeline Co. v. FERC*, 820 F.2d 733, 744 (5th Cir. 1987).¹⁸

Indeed, the demand that the Commission—under penalty of forfeiting its judgmental conclusion on increased price for old gas, abandonment and mandatory transportation—consider and then solve this problem of which Congress has been acutely aware, and has similarly ducked, is, most charitably, audacious. So audacious is it that it approaches a similar demand by some court someplace that either Congress or the Department of Defense solve the problem of terrorism as a condition to appropriating funds for the maintenance and upkeep of the prisoner stockade at Fort Sam Houston, Texas.

This is contrary to the demands not only of administrative law, but of the review of legislation, state or federal. The Supreme Court has long recognized that "[e]vils in the same field may be of different dimensions and proportions, requiring different remedies. . . . [O]r the reform may take one step at a time, addressing itself to the phase of the problem which seems most acute to the legislative mind." *Williamson v. Lee Optical of Oklahoma, Inc.*, 348 U.S. 483, 489, 75 S.Ct. 461, 465, 99 L.Ed. 563

¹⁸ The Commission's brief advises the Court that the Commission is particularly addressing these issues in the proceedings on remand of *Associated Gas Distributors*, Order No. 500; Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol: Interim Rule and Statement of Policy [Reg. Preambles 1982-1985], III FERC Stats. & Regs. ¶ 30,761 (1987), *modified and reh'g denied*, Order No. 500-B, III FERC Stats. & Regs. ¶ 30,772, *further modified*, Order No. 500-C, III FERC Stats. & Regs. ¶ 30,786 (1987), Order No. 500-D, III FERC Stats. & Regs. ¶ 30,800 (March 8, 1988), *reh'g denied*, Order No. 500-E, 43 FERC ¶ 61,234 (May 6, 1988), 53 Fed.Reg. 16,859 (May 12, 1988); petitions for review filed *sub nom. American Gas Association v. FERC*, (D.C.Cir. No. 87-1588).

(1955); see also *Schweiker v. Wilson*, 450 U.S. 221, 238, 101 S.Ct. 1074, 1084, 67 L.Ed.2d 186 (1981).

Additionally, the Commission provides pipelines with the means to address take-or-pay problems within the context of its rulemaking. First, pipelines are given something tangible (higher old gas prices) to bargain against take-or-pay liability. Second, when producers, under GFN, seek to raise an old gas price, pipelines can require the direct renegotiation of the sellers' high-cost gas sales that are being sold under mixed contracts. Third, the pipeline can terminate its contract obligations as to both the old gas and high-cost gas sold under mixed contracts. In short, as the Commission found, the pipelines were given substantial bargaining leverage against producers' uneconomic contracts.¹⁹

Tag Ends

Like the Court in its opinion, I find undeserving of specific comment the other attacks on the Commission's 451 Orders.

Where it All Ends

Committed, as we are, to the Commission's necessitous right of experimentation in a matter so complex and nearly beyond congressional solution, this Court's action in nullifying the 451 Orders is an unauthorized intrusion into a field which neither Article III nor legislation commands.

I therefore, respectfully dissent.

¹⁹ The Commission's brief advises that to date under the Commission Order No. 500 series, eight pipelines have reached in the aggregate over \$3.9 billion in settlements of take-or-pay liability. See Commission's brief, at note 55 (citing specific cases).

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APPENDIX B

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 86-4940

MOBIL OIL EXPLORATION and PRODUCING
SOUTHEAST, INC., *et al.*,
Petitioners,
versus

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

Petitioners for Review of an Order of the
Federal Energy Regulatory Commission

ON PETITIONS FOR REHEARING AND SUGGES-
TIONS FOR REHEARING EN BANC
(Opinion 9/15/89, 5 Cir., 198 —, — F.2d —)
(December 15, 1989)

Before CLARK, Chief Judge, BROWN and JOHNSON,
Circuit Judges.

PER CURIAM:

(X) The Petitions for Rehearing are DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (Federal Rules of Appellate Procedure and Local Rule 35) the Suggestions for Rehearing En Banc are DENIED. Judge Brown continues in his dissent.

ENTERED for the COURT:

/s/ Sam Johnson
United States Circuit Judge

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APPENDIX C

SUPREME COURT OF THE UNITED STATES

No. A-503

MOBIL OIL EXPLORATION & PRODUCING
SOUTHEAST, INC., *et al.*,
Applicants,

v.

UNITED DISTRIBUTION COMPANIES, *et al.*

ORDER

UPON CONSIDERATION of the application of counsel for the applicants,

IT IS ORDERED that the mandate of the United States Court of Appeals for the Fifth Circuit, case No. 86-4940, is stayed pending receipt of responses to the application and further order of the undersigned or of the Court.

/s/ BYRON R. WHITE
Associate Justice
of the Supreme Court
of the United States

Dated this 10th day of January, 1990.

APPENDIX D

SUPREME COURT OF THE UNITED STATES

No. A-503

MOBIL OIL EXPLORATION & PRODUCING
SOUTHEAST, INC., *et al.*,
Appellants,

v.

UNITED DISTRIBUTION COMPANIES, *et al.*

ON CONSIDERATION of the application for stay of mandate of the United States Court of Appeals for the Fifth Circuit presented to Justice White and by him referred to the Court,

IT IS ORDERED by this Court that the said application be, and the same is hereby, granted and the mandate is stayed pending the timely filing and disposition of the petitions for writs of certiorari. If the petitions for writs of certiorari are denied, this order terminates automatically. Should the petitions for writs of certiorari be granted, this order is to remain in effect pending the sending down of the judgment of this Court.

January 16, 1990

APPENDIX E

Regulations Adopted or Amended Pursuant to Orders
451 and 451-A, 18 C.F.R. Part 154 et seq.

§ 157.301 Blanket certificate authority, pre-granted
abandonment, and reporting requirements.

(a) *Blanket certificate authority.* Any first seller of natural gas that is authorized to abandon the sale of gas under the good faith negotiation procedures set forth in § 270.201 of this chapter is granted a certificate of public convenience and necessity to sell such gas for resale in interstate commerce, subject to the reporting requirements of paragraph (c) of this section.

(b) *Pre-granted abandonment.* Any first seller who sells natural gas under the blanket certificate authority of paragraph (a) of this section is authorized to abandon the sale upon termination of the contract under which the sale is made.

(c) *Reporting requirement.* Any first seller who makes sales under the blanket certificate authority of this section must file a report with the Commission not later than April 1 of each year providing the following information with respect to any sales under that certificate initiated during the preceding calendar year:

- (1) Name of former purchaser;
- (2) Name of new purchaser;
- (3) Location of sale (field, block, county, state, etc.);
- (4) Contract date;
- (5) Contract term;
- (6) Average price; and
- (7) Estimated annual sales volume (mcf).

(d) *Waiver of rate filing requirements.* The rate filing requirements of §§ 154.92 and 154.94 of this chapter are

waived for sales under a certificate granted by this section.

§ 270.201 Good faith negotiation procedures.

(a) *Applicability, definitions, and general rules.* (1) This section applies to requests for renegotiation of the price of old gas sold under an existing contract.

(2) For purposes of this section:

(i) "Old gas" means natural gas which, if sold, would be subject to a maximum lawful ceiling price under section 104 or 106(a) of the NGPA.

(ii) (A) "Existing contract" means a contract in effect on July 18, 1986, or an expired contract pursuant to which sales of natural gas are continuing on that date under the service obligation of a certificate of public convenience and necessity, that includes the sale of any old gas and provides authority for the first seller to collect a higher price upon establishment by the Commission of a higher maximum lawful price.

(B) An existing contract includes the sale of old gas if, on July 18, 1986, the contract encompasses the sale of any gas that has not been abandoned under section 7(b) of the Natural Gas Act and which, if sold, would be priced as old gas, whether or not any old gas is sold on that date.

(iii) The terms "first seller" and "party to a contract" include:

(A) An owner of a working interest in an oil or gas lease that has a direct contractual relationship with a purchaser for a "first sale" of gas, as defined in section 2(21) of the NGPA; and

(B) An operator of an oil or gas lease that has a direct contractual relationship with a purchaser for a "first sale" on behalf of any owner of a working interest in the lease that does not have such a relationship.

(3) (i) Any existing contract under which old gas is sold may be renegotiated or amended at any time to provide for a price up to the alternative maximum lawful price under § 271.402(c)(7)(i) of this chapter without using the good faith negotiation procedures.

(ii) A price for old gas that exceeds the otherwise applicable maximum lawful price under § 271.402 of this chapter may be collected under an existing contract only if the first seller and purchaser agree upon a price up to the alternative maximum lawful price under § 271.402(c)(7)(ii) in accordance with this section.

(4) A party to an existing contract may not request a nomination of a price under the provisions of this section for any gas sold under the contract, if that party:

(i) And the purchaser or first seller have renegotiated the price or any other term for the sale of any old gas under the contract after July 18, 1986, without using the good faith negotiation procedures of this section, and have not agreed in writing to preserve their rights under this section;

(ii) Has previously requested nomination of a price under paragraph (b)(1) of this section for any gas sold under the contract; or

(iii) Has been requested under this section to nominate a price for any gas sold under the contract, and the last date has passed under paragraphs (b)(2) or (b)(3) of this section to request the other party to nominate a price for gas sold under the contract.

* * * * *

(6) Any request for nomination of a price under this section, any nomination of a price in response to such a request, and any notice of abandonment of sales or termination of purchases under this section must be sent by U.S. mail, return receipt requested.

(7) Any deadline under this section for requesting a nomination of a price, or for nominating a price in re-

sponse to such a request, may be extended by mutual agreement of the parties in writing. Any notice required under this section to be given before a first seller or purchaser abandons or terminates sales or purchases may be shortened by mutual agreement of the parties in writing.

(8) A party nominating a price may propose a change in any other terms of the existing contract, and for purposes of this section, the terms "nominated price" and "nomination" may include such a proposed change.

(b) Requests for negotiation and nomination of price.

(1)(i) At any time after January 23, 1987, a first seller may request the purchaser to nominate a price at which the purchaser is willing to continue buying old gas under any existing contract by submitting a written request to the purchaser, and may specify the wells or category of wells under each contract for which the first seller requests a renegotiated price.

(ii) When requesting a nomination of a price under this paragraph, a first seller may also request the purchaser to provide the first seller with a current list of all of the purchaser's firm sales customers, including the name and address of an employee or agent responsible for negotiating purchases of natural gas on behalf of the customer. The purchaser must send the list of customers to the first seller within 30 days after receiving the request, and must include a certificate of its completeness and accuracy. The list must be sent by U.S. mail, return receipt requested.

(2) Within 30 days after receiving a request for nomination of a price under paragraph (b)(1) of this section, the purchaser may request the first seller to nominate a price at which the first seller is willing to continue selling any gas, including old gas for which the first seller has requested a nomination of price by the purchaser, under

any existing contract with the purchaser that includes the sale of any old gas, whether or not named in the first seller's request, by submitting a written request to the first seller.

(3) Within 30 days after receiving a request from a purchaser for nomination of a price for any gas under a contract that is not named in the first seller's request and that includes the sale of any old gas, the first seller may request the purchaser to nominate a price at which the purchaser is willing to continue buying any old gas under that contract, including old gas for which the purchaser has requested a nomination of price by the first seller, by submitting a written request to the purchaser.

(4) A first seller's request for nomination of a price under paragraph (b)(1) of this section constitutes an offer to release the purchaser from its contract obligation to purchase any gas sold under any existing contract with the first seller, whether or not named in the first seller's request, that includes the sale of any old gas.

* * * *

(c) No response to request for nomination. (1) If the purchaser does not nominate a price in writing within 60 days after receiving the first seller's request for nomination of a price, the first seller may offer to sell all or part of the gas named in its request for nomination to a new purchaser. The first seller is authorized, upon 30-days written notice to the existing purchaser, to abandon the sale of the gas if the first seller enters into a written contract for the sale of all or part of the gas to a new purchaser after any necessary compliance with paragraph (g) of this section.

(2) If the first seller does not nominate a price in writing within 60 days after receiving the purchaser's request for nomination of a price, the purchaser may terminate its purchases of all or part of the gas named in its re-

quest for nomination at any time upon 60-days written notice to the first seller.

(d) *Purchaser's nomination of highest price.* If the purchaser nominates in writing the highest price to which an existing contract price could escalate with the purchaser's agreement under § 271.402(c)(7)(ii) of this chapter, and the purchaser does not propose a change in any term of the contract, sales must continue at the nominated price under the terms of the existing contract.

(e) *Purchaser's nomination of lower price; first seller's options.* (1) If the purchaser nominates in writing a price less than the highest price to which the existing contract price could escalate or proposes a change in any other term of the contract, the first seller must accept or reject the nominated price in writing within 30 days after receiving the nomination. If the first seller does not accept the purchaser's nominated price in writing within 30 days, the nominated price is deemed rejected.

(2) If the first seller accepts the nominated price, sales must continue at the agreed-upon price under the other terms of the existing contract, unless such terms are renegotiated by the parties.

(3) If the first seller rejects the nominated price, the first seller must continue sales to the purchaser at the existing price until the sale of the gas is abandoned under this paragraph. At any time after a rejection, the first seller may offer to sell to a new purchaser all or part of the gas for which no price is agreed upon under this paragraph.

(4) A first seller is authorized, upon 30-days written notice to the existing purchaser, to abandon the sale of any gas offered under this paragraph for which the first seller enters into a written contract with a new purchaser after any necessary compliance with paragraph (g) of this section.

(f) *First seller's nomination of price; purchaser's options.* (1) If the first seller nominates a price in writing in response to the purchaser's request under paragraph (b)(2) of this section, the purchaser must accept or reject the nominated price in writing within 30 days after receiving the nomination. If the purchaser does not accept the first seller's nominated price in writing within 30-days, the nominated price is deemed rejected.

(2) If the purchaser accepts the nominated price, purchases must continue at the agreed-upon price under the other terms of the existing contract, unless such terms are renegotiated by the parties.

(3) If the purchaser rejects the nominated price, the purchaser may at any time terminate its purchases of all or part of the gas named in its request for nomination upon 60-days written notice to the first seller.

(4) The terms of the existing contract apply until the purchaser accepts the first seller's nominated price or terminates purchases of the gas under this paragraph.

(5) A first seller is authorized to abandon sales of the gas to the purchaser if the purchaser terminates purchases of gas under this section and the first seller enters into a written contract for the sale of the gas to a new purchaser after any necessary compliance with paragraph (g) of this section.

(g) *Existing firm sales customers' right of first refusal—*(1) *General rule.* (i) If the first seller offers to sell gas subject to release due to termination or abandonment under paragraphs (c), (e), or (f) of this section ("offer") to a new purchaser that is not an existing firm sales customer of the existing purchaser, the first seller must present the same offer to all existing firm sales customers, if:

(A) The existing purchaser is not subject to the non-discriminatory access provisions of § 284.8(b) or § 284.9(b) of this chapter, and;

(B) The offer encompasses the sale of any gas subject to the Commission's jurisdiction under section 1(b) of the Natural Gas Act and is substantially accepted in principle by the new purchaser in an arms-length transaction.

(ii) Any existing firm sales customer has a right of first refusal to purchase the gas under the terms of the offer. The offer must be presented in accordance with the provisions of this paragraph.

(2) *Making the offer.* The offer to a new purchaser that is not an existing firm sales customer must be presented to all such customers of the existing purchaser not later than 10 days after the offer is substantially accepted in principle by the new purchaser. The offer must be tendered by U.S. mail, return receipt requested.

(3) *Acceptance and rejection of offer; no counteroffer.*

(i) An existing firm sales customer must accept the offer in writing within 20 days after receiving the offer. The offer is deemed accepted when it is signed and placed in the U.S. mail, return receipt requested. If the offer is not accepted by an existing firm sales customer within 20 days of its receipt, the offer is deemed rejected.

(ii) Any written counteroffer by an existing firm sales customer constitutes a rejection.

(iii) If the first seller receives more than one acceptance from an existing firm sales customer, the first seller may determine which such customer will become the new purchaser.

(4) *Termination of right of first refusal.* If no existing firm sales customer accepts the offer made under this paragraph within 20 days of receiving the offer, the first seller may execute a written contract with the new purchaser that substantially accepted the offer before it was sent to the existing firm sales customers. Such written contract with a new purchaser is not subject to a right of first refusal.

(5) *Definition.* For purposes of this section, "existing firm sales customer" means a customer with which the existing purchaser has a contract for the sale of gas not subject to a prior claim by another customer or another class of service, and at the same priority as any other class of firm service, which is in effect on the date a new purchaser substantially accepts in principle an offer under paragraph (g) (1) of this section.

(h) *Transportation by existing pipeline purchaser.* A purchaser that is an interstate pipeline not subject to the non-discriminatory access provisions of § 284.8(b) or § 284.9(b) of this chapter must transport any gas released due to termination or abandonment under this section, on behalf of any shipper, to any existing customer of the interstate pipeline or to any pipeline to which the interstate pipeline is interconnected, and in accordance with § 284.225 of this chapter, if the purchaser:

(1) Does not submit a timely nomination of a price for gas under paragraph (c) (1) of this section in response to the first seller's request for nomination of a price;

(2) Nominates a price under paragraph (e) (1) of this section that is less than the highest price to which its existing contract price could escalate if it were a new or amended contract;

(3) Terminates purchases of gas under paragraph (c) (2) of this section when the first seller does not submit a timely nomination of a price; or

(4) Terminates purchases of gas under paragraph (f) (3) of this section after rejecting a price for gas nominated by the first seller.

§ 271.402 Maximum lawful prices.

• • • • •
(c) *Applicable higher rates.* • • •

(3) In the case of any first sale under any rollover contract to which this subpart applies, the maximum lawful price for the month in which the effective date of such rollover contract occurs is the highest of:

(i) the maximum lawful price applicable to the expiring contract in the month in which the rollover contract becomes effective;

(ii) the price specified in Table II of § 271.101(a) for interstate rollover gas; or

(iii) the price specified in Table II of § 271.101(a) for post-1974 gas if the rollover contract becomes effective after July 18, 1986.

• • • • •
(5) Any seller seeking to charge a rate in excess of the applicable maximum lawful price described in paragraphs (a), or (c) (1), (c) (2), or (c) (7) of this section must file a petition seeking special relief fully justifying the relief sought. • • •

• • • • •
(7) The maximum lawful price, per MMBtu, for the first sales of all categories of gas otherwise subject to lower maximum lawful prices under this subpart is the price specified in Table II or § 271.101(a) for post-1974 gas, if the price is established:

(i) Under a contract or contract amendment executed after July 18, 1986; or

(ii) In accordance with the good faith negotiation procedures of § 270.201 of this chapter.

§ 271.602 Maximum lawful price.

(a) *General rule.* The maximum lawful price for a first sale of natural gas under an intrastate rollover con-

tract to which section 106(b) (1) of the NGPA applies is the highest of:

(1) (i) The maximum lawful price, per MMBtu, paid under the expired contract in the month in which the rollover contract becomes effective; and

(ii) In any month after the month in which the rollover contract becomes effective, the maximum lawful price, per MMBtu, prescribed under this paragraph for the preceding month adjusted for inflation in accordance with § 271.102;

(2) the alternative maximum lawful price specified in Table I of § 271.101(a) for certain intrastate rollover gas; or

(3) the price specified in Table II of § 271.101(a) for post-1974 gas, if the price is established under a contract or contract amendment executed after July 18, 1986.

• • • • •
§ 284.225 Transportation by interstate and intrastate pipelines of gas released under the good faith negotiation procedures.

(a) *Applicability.* This section applies to any interstate pipeline that must transport natural gas under paragraph (h) of the good faith negotiation procedures in § 270.201 of this chapter, and to any intrastate pipeline that purchased gas immediately before its release due to termination or abandonment under § 270.201(c), (e), or (f) of this chapter.

(b) *Blanket certificate for interstate pipelines.* An interstate pipeline is granted a blanket certificate of public convenience and necessity that authorizes firm and interruptible transportation of natural gas to any existing customer of the interstate pipeline or to any pipeline to which the interstate pipeline is interconnected, if the gas is released due to termination or abandonment under § 270.201(c), (e), or (f) of this chapter.

• • • • •

(d) *Definition.* For purposes of this section, "existing customer" means a customer with which the interstate or intrastate pipeline has a contract for the sale or transportation of gas which is in effect on the date a written contract is executed to purchase the gas for which transportation service is available under this section.

(e) *Transportation rates—*(1) *Transportation service within contract demand.* If a pipeline provides transportation of gas to an existing customer under this section and, as a result, the total volumes of gas sold and transported to that customer on a firm basis do not exceed existing firm contract demand by that customer, the interstate pipeline:

(i) Must base its transportation rate for such gas on the rate in a transportation rate schedule on file with the Commission that conforms to § 284.7 and § 284.8(d);

(ii) Must waive any transportation reservation fee to the extent that a customer pays for facilities associated with such transportation service through demand charges under its firm sales rate schedule;

(iii) Must credit the volumes of gas transported against any minimum commodity bill obligation; and

(iv) May recover costs, on an Mcf or MMBtu basis, associated with standing by to serve a firm sales rate schedule customer that does not reduce its contract demand, if the interstate pipeline revises its sales rate schedules on file with the Commission.

(2) *Transportation service in excess of contract demand.* If an interstate pipeline provides transportation of gas to an existing customer under this section and, as a result, the total volumes of gas sold and transported to that customer exceed existing firm contract demand to that customer, the transportation rate for such gas must be the rate in a transportation rate schedule on file with the Commission that conforms to § 284.7 and either

§ 284.8(d) for firm service or § 284.9(d) for interruptible service.

(3) *Transportation service for other customers.* If an interstate pipeline provides transportation of gas under this section to any pipeline or customer other than an existing customer on a firm basis, the transportation rate for such gas must be the rate in a transportation rate schedule on file with the Commission that conforms to § 284.7 and either § 284.8(d) for firm service or § 284.9(d) for interruptible service.

(4) *Interim rates.* If an interstate pipeline does not have a transportation rate schedule on file with the Commission that conforms to § 284.7 and either § 284.8(d) for firm service or § 284.9(d) for interruptible service, the interstate pipeline must file such a rate schedule within 60 days after first providing transportation service under this section. Until such a rate schedule becomes effective, the interstate pipeline must provide the transportation service using the rate in one of the interstate pipeline's transportation rate schedules on file with the Commission which the interstate pipeline determines covers service comparable to transportation service authorized under this section.

* * * *

(g) *Reporting requirements.* An interstate pipeline that transports gas under a certificate granted by this section is subject to the reporting requirements of § 284.223(f). An intrastate pipeline that transports gas under a certificate granted by this section is subject to the reporting requirements of § 284.126.

(h) *Terms and conditions of service.* (1) The terms and conditions of service provided under a blanket certificate granted by this section must conform to the transportation requirements of the shipper, subject to reasonable operating conditions of the pipeline and its available pipeline capacity.

(2) An interstate pipeline that transports gas under a certificate granted by this section and is not otherwise subject to the non-discriminatory access provisions of § 284.8(b) or § 284.9(b) is not required to transport on behalf of others any gas not released due to termination or abandonment under the good faith negotiation procedures of § 270.201 of this chapter.

(3) If a pipeline that transports gas under a certificate granted by this section becomes subject to the non-discriminatory access provisions of § 284.8(b) or § 284.9(b), its authority and service obligation under the certificate to transport gas purchased under a contract in effect before the pipeline becomes subject to those provisions terminates only when the contract expires or is terminated.

§ 284.226 Transportation by interstate and intrastate pipelines upstream of pipelines releasing gas under the good faith negotiation procedures.

(a) *Applicability.* This section applies to any upstream interstate or intrastate pipeline that is not subject to the non-discriminatory access provisions of § 284.8(b) or § 284.9(b) of this chapter and that provided transportation of gas immediately prior to its release by any interstate or intrastate pipeline due to termination or abandonment under the good faith negotiation procedures in § 270.201 of this chapter. Such upstream pipelines were those authorized under any Commission regulation to transport natural gas, prior to the release of that gas due to termination or abandonment under § 270.201(c), (e), or (f) of this chapter, along any line between the wellhead and the pipeline that purchased the gas immediately before its release.

(b) *Blanket Certificate.* (1) Upstream interstate pipelines are granted a blanket certificate of public convenience and necessity that authorizes transportation of natural gas released due to termination or abandonment

under § 270.201 (c), (e) or (f) of this chapter on behalf of any shipper to any interstate pipeline releasing gas under § 270.201 of this chapter, under the same terms and conditions as previously provided to the releasing pipeline.

* * * * *

(c) *Transportation rates.* The rates charged by such third-party, upstream pipelines for transportation under this section shall be identical to the rates charged under any pre-existing transportation authorization for the same service previously provided to the releasing pipeline.

(d) *Reporting requirements.* An interstate pipeline that transport gas under the certificate granted by this section is subject to the reporting requirements of § 284.223(f). An intrastate pipeline that transports gas under the certificate granted by this section is subject to the reporting requirements of § 284.126.

APPENDIX F

Following is list of the petitioners joining this Application. Petitioners are listed in capital letters. Pursuant to Rule 29.1, parent companies and subsidiaries (except wholly owned subsidiaries), if any, are listed under each such petitioner.

AMOCO PRODUCTION COMPANY

Amoco Company (parent)
 Amoco Corporation (parent)
 East Texas Salt Water Disposal Company
 Gravcap, Inc.
 Heat Transfer Research, Inc.
 Sultran, Ltd.

ANADARKO PETROLEUM CORPORATION

(Anadarko Petroleum has no parent corporation or subsidiaries other than those it wholly owns.)

ARCO OIL & GAS COMPANY

Atlantic Richfield Company (parent)
 85819 Canada Limited
 Agro Internacional, S. de R. L. de C.V.
 Alyeska Pipeline Service Company
 ARCO Channelview, Inc.
 ARCO Chemical Company
 ARCO China Inc.
 ARCO Solar Nigeria Ltd.
 Badger Pipeline Company
 Black Lake Pipe Line Company
 Blair Athol Coal Pty, Limited
 Colonial Pipeline Company
 Compania de Petroleo Ganso Azul, Ltda
 Compania Minera Dos Republicas S.A. de C.V.
 Cook Inlet Pipe Line Company
 Dixie Pipeline Company
 East Texas Salt Water Disposal Co.
 Iricon Agency Ltd.

Kenai Pipe Line Company
 Kuparuk Transportation Company
 Las Quintas Serenas Water Company
 Logan Aluminum Inc.
 Lyondell Petrochemical Company
 Murlfill Pty. Ltd.
 Platte Pipe Line Company
 Showa ARCO Solar Far East Pte. Ltd.
 Tecumseh Pipe Line Company
 Texas-New Mexico Pipe Line Company

ASHLAND EXPLORATION, INC.

Ashland Exploration Holdings, Inc. (parent)
 (Ashland Exploration, Inc. has no subsidiaries other than those it wholly owns.)

CHEVRON U.S.A. INC.

Chevron Corporation (parent)
 Atlas Supply Company
 Felix Oil Company
 Pembroke Company, Inc.

CONOCO, INC.

E. I. Du Pont De Nemours, Inc. (parent)
 Big Sky of Montana Realty, Inc.
 Cit-Con Oil Corporation
 Conch International Methane Ltd.
 Conoco Amazonos Limited
 Conoco Arabia Limited
 Conoco Buton Ltd.
 Conoco Cabinda (Angola) Ltd.
 Conoco Cegonha (Angola) Ltd.
 Conoco Dabaa Ltd
 Conoco El Hamma (Tunisia) Ltd.
 Conoco Faghur Ltd.
 Conoco Iraq Ltd.
 Conoco Kayes (Congo) Ltd.

Conoco Kouilou (Congo) Ltd.
 Conoco N-dombo (Gabon) Ltd.
 Conoco North Ras Qattara Ltd.
 Conoco North Sitra Ltd.
 Conoco Onango (Gabon) Ltd.
 Conoco Peru
 Conoco South Umbarka Ltd.
 Conoco Spain Ltd.
 Conoco Warim Ltd.
 Conoco West Ras Qattara Ltd.
 Conoco Yemen (Aden) Ltd.
 Conoco Yemen (Sanaa) Ltd.
 Dubai Exploration Onshore Company
 Felix Oil Company
 Jupiter Chemicals, Inc.
 Kettleman North Dome Association
 Oberrheinische Mineraloelwerke
 Petrocokes, Ltd.
 Petroleum Terminals, Inc.
 The Standard Shale Products Company
 Tidelands Royalty Trust

EXXON CORPORATION

(Exxon Corporation has no parent corporation.)
 Exxon Capital Corporation
 Exxon Capital Holdings Corporation
 Exxon Capital Ventures Inc.
 Exxon Credit Corporation
 Exxon Financial Services Company Limited
 Exxon Funding B.V.
 Exxon Pipeline Company
 Exxon Shipping Company
 Exxon Supply Company
 Imperial Oil Limited
 Interhome Energy Inc.
 Scurry-Rainbow Oil Limited

HUNT OIL COMPANY

Hunt Consolidated, Inc. (parent)
 Portal Pipe Line Company
 Poloma Pipe Line Company

MARATHON OIL COMPANY

USX Corporation (parent)
 Arctic LNG Transportation Company
 Kenai LNG Corporation
 Oil Insurance Limited
 Polar LNG Shipping Corporation

MOBIL OIL EXPLORATION & PRODUCING SOUTHEAST, INC.

Mobil Corporation (parent)
 Paloma Pipe Line Company

ORYX ENERGY COMPANY

(Oryx Energy Company has no parent corporation.)
 Sun Energy Partners, L.P.

OXY USA Inc.

Occidental Petroleum Corporation (parent)
 (Oxy USA Inc. has no subsidiaries other than those
 it wholly owns.)

PENNZOIL COMPANY

(Pennzoil Company has no parent corporation.)
 Jiffy Lube International, Inc.
 Proven Properties, Inc.
 Pennzoil (U.K.) Limited

PHILLIPS PETROLEUM COMPANY

(Phillips Petroleum Company has no parent
 corporation.)
 Venezoil, C.A.

PHILLIPS 66 NATURAL GAS COMPANY

Phillips Petroleum Company (parent)
Kenai LNG Corporation
Arctic LNG Transportation Company
Polar LNG Shipping Corporation

PLAINS PETROLEUM CO.

(Plains Petroleum Co. has no parent corporation or subsidiaries other than those it wholly owns.)

ROSEWOOD RESOURCES, INC.

(Rosewood Resources has no parent corporation or subsidiaries other than those it wholly owns.)

SHELL OFFSHORE INC.

Shell Oil Corporation (parent)
(Shell Offshore, Inc. has no subsidiaries other than those it wholly owns.)

SHELL WESTERN E & P INC.

Shell Oil Corporation (parent)
East Texas Salt Water Disposal Company
Grande Ecaille Land Company
Van Salt Water Disposal Company
Wyoming Industrial Development Corporation

TEXACO INC.

(Texaco Inc. has no parent corporation.)
Getty Oil Company
Texaco Cogeneration Company
Texaco Pipeline Inc.
Texaco Producing Inc.
Texaco Refining and Marketing Inc.
Texaco Trading and Transportation Inc.
Norsk Texaco Oil A/S
S.A. Texaco Belgium N.V.

Texaco A/S
Texaco Britain Limited
Texaco Denmark Inc.
Texaco Investments (Netherlands), Inc.
Texaco (Ireland) Limited
Texaco Limited
Texaco North Sea U.K. Company
Texaco Oil Aktiebolag
Texaco Petroleum Maatschappij (Nederland) B.V.
Refineria Panama S.A.
Refineria Texaco de Honduras, S.A.
Texaco Brasil S.A.—Productos de Petroleo
Texaco Caribbean Inc.
Texaco Nigeria Limited
Texaco Panama Inc.
Texaco Petroleum Company
Texaco Puerto Rico Inc.
Texaco Trinidad, Inc.
Texaco Petroleum Company
Texaco Chemical Company
Texaco International Financial Corporation
Texaco International Trader Inc.
Texaco Overseas Holdings Inc.
Texaco Overseas Petroleum Company
Texaco Overseas Tankship Ltd.
Canada Texaco Inc.
Four Star Oil & Gas Company
Texaco Canada Petroleum Inc.
Texaco Refining and Marketing Holdings Inc.

UNION OIL COMPANY OF CALIFORNIA

Unocal Corporation (parent)
Union Exploration Partners, Ltd.
Unocal Thailand, Ltd.
Midwest 76, Inc.

UNION PACIFIC RESOURCES COMPANY

Union Pacific Corporation (parent)
CPC Resources Corporation

Golden Spike Indonesia, Inc.
Harbor Service Stations, Inc.
Quality Aggregate Company
Rocky Mountain Energy Company
Union Pacific Arguello Pipeline, Inc.
Union Pacific Australia PTY Ltd.
Union Pacific Energy Company
Union Pacific Fuels, Inc.
Union Pacific Gas Gathering, Inc.
Union Pacific Gas Pipeline, Inc.
Union Pacific Gas Processing Company
Union Pacific International Petroleum Company
Union Pacific Malaysia, Inc.
Union Pacific Minerals, Inc.
Union Pacific Petrochemicals, Inc.
Union Pacific Pipeline Company
Union Pacific Pipeline, Inc.
Union Pacific Refining, Inc.
Union Pacific Resources Inc.
Union Pacific Resources Indonesia, Inc.
Union Pacific Trading Company
UPR (Canada) Ltd.

UNION TEXAS PETROLEUM CORPORATION

Union Texas Petroleum Holdings, Inc. (parent)
Union Texas Exploration Corporation
Union Texas International Corporation